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A Survey of Environmental Justice Legislation in the States

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RECENT DEVELOPMENTS

A SURVEY OF ENVIRONMENTAL JUSTICE LEGISLATION IN THE STATES

I. INTRODUCTION

In April of 1993, Irma Hunter Brown, an African-American Arkansas representative, who lives near a toxic waste facility, convinced the Arkansas legislature to enact the first state law on environmental equity and justice.¹ The "Environmental Equity Act"² seeks to prevent the concentration of solid waste disposal facilities in lower income and minority communities.³

The environmental justice movement seeks to combat distributional inequities of environmental protection⁴ by prohibiting the construction of new facilities unless they meet certain criteria.⁵ It has gathered force in recent years because of a growing recognition that low income and minority communities are disproportionately burdened by environmental hazards.⁶ The movement has also gained strength because studies have found that these same communities receive less governmental protection and experience slower governmental responses to environmental dangers than non-minority communities.⁷

While several commentators have explored the effectiveness of

1. William Claiborne, *More Nonwhites Are Living Near Toxic Waste Sites; Racial Disparities Have Grown Despite National Focus on Issue*, WASH. POST, Aug. 25, 1994, at A17.

2. Siting High Impact Solid Waste Management Facilities Act of Apr. 20, 1993, No. 1263 (codified at ARK. CODE ANN. 8-6-1501-1504 (Michie 1993)).

3. ARK. CODE ANN. § 8-6-1501(b) states:

The General Assembly also acknowledges that, while solid waste management facilities are essential, certain types of facilities impose specific burdens on the host community. National trends indicate a tendency to concentrate high impact solid waste disposal facilities in lower income or minority communities. Such facilities may place an onus on the host community without any reciprocal benefits to local residents. The purpose of this subchapter is to prevent communities from becoming involuntary hosts to a proliferation of high impact solid waste management facilities.

4. See Richard J. Lazarus, *Pursuing Environmental Justice: The Distributional Effects of Environmental Protection*, 87 N.W. L. REV. 787, 824 (1993).

5. See *infra* notes 96-101 and accompanying text.

6. See *infra* notes 9-24 and accompanying text.

7. *Id.*

combatting environmental injustice through the judicial system,⁸ this Recent Development argues that states should pursue environmental justice through legislation that regulates the siting of toxic and hazardous waste facilities. Part II briefly explores the mounting evidence that environmental injustice exists. Part III outlines the current state approaches to a siting of hazardous waste facilities and the resulting distributional equity or inequity. Part IV analyzes the siting approach adopted by the Arkansas legislature and compares this statute to other legislative schemes currently under consideration in other states. Finally, Part V proposes a model state act that will best achieve environmental equity for current and future generations.

II. EVIDENCE OF ENVIRONMENTAL INEQUITY

In 1983, the General Accounting Office (GAO) conducted the first study on environmental racism.⁹ The GAO examined hazardous waste landfills in eight southeastern states that comprise the Environmental Protection Agency's (EPA) Region IV. It found that African-Americans constituted a majority of the population in three of the four communities hosting landfills.¹⁰ Although the study showed that a positive correlation between the racial composition of these communities and the location of hazardous landfills, its narrow scope has prevented others from generalizing about the study's results.¹¹

Consequently, in 1987, the United Church of Christ Commission for Racial Justice (UCC) conducted a far more comprehensive study of environmental racism.¹² The report concluded that although socio-

8. See, e.g., James Colopy, *The Road less Travelled: Pursuing Environmental Justice Through Title VI of the Civil Rights Act of 1964*, 13 STAN. ENVTL. L. J. 125 (1994); Lazarus, *supra* note 4, at 827-42 (advocacy Title VI challenge).

9. U.S. GEN. ACCOUNTING OFFICE, SITING OF HAZARDOUS WASTE LANDFILLS AND THEIR CORRELATION WITH RACIAL AND ECONOMIC STATUS OF SURROUNDING COMMUNITIES (1983).

10. *Id.* at 4. African-Americans made up 52%, 66%, and 90% of the population in those three communities. The General Accounting Office (GAO) also found that between 26% and 42% of the population in the four host communities lived below the poverty level.

11. *Id.* at 13.

The GAO study, while important, was limited by its regional scope. It was not designed to examine the relationship between the location of hazardous waste facilities throughout the United States and the racial and socio-economic characteristics of persons residing near them. Nor, prior to our current report, had there been a study to ascertain whether the GAO finding was indicative of any national patterns.

Id.

12. UNITED CHURCH OF CHRIST COMMISSION FOR RACIAL JUSTICE, TOXIC WASTES AND RACE IN THE UNITED STATES (1987). The Commission's study purported to conduct two cross-sectional, nationwide studies to determine the extent to which African-Americans, as well as other minority

economic status had a positive correlation with the location of hazardous waste facilities, race constituted a more significant factor.¹³ Even after accounting for urbanization and regional differences, a higher correlation between race and the location of hazardous waste facilities remained.¹⁴

Due to the enormous publicity and subsequent controversy arising from the UCC and GAO studies, the EPA formed an intra-agency group to evaluate agency policies from an environmental equity perspective.¹⁵ In 1992, this "Environment and Equity" working group produced a report¹⁶ that acknowledged that minorities experience greater exposure to certain pollutants.¹⁷ However, it did not recognize the existence of a clear connection between race and environmental hazards. The report concluded that the EPA needed to gather more data on the environmental health effects experienced by different racial and socio-economic groups.¹⁸

But, in contrast to the EPA study, a 1992 study by the National Law Journal not only found a clear nexus between race and environmental hazards, but also uncovered less protective environmental cleanup and less

groups, were exposed to hazardous wastes in their communities. *Id.* at ix.

13. *Id.* at xiii - xiv. The studies examined demographic patterns associated with commercial hazardous waste facilities and uncontrolled toxic waste sites. *Id.* at xiii. In studying the demographic characteristics of communities with commercial hazardous waste facilities, the studies revealed that communities containing two or more facilities or one of the nation's five largest landfills, had on average, a minority population that exceeded the minority population in communities without facilities (38% vs. 12%). *Id.*

The study determined that "three out of the five largest commercial hazardous waste landfills in the United States were located in predominantly [African-American] or Hispanic communities. These three landfills comprised 40% of the total estimated commercial landfill capacity in the nation." *Id.* at xiv.

The studies' examination of communities with uncontrolled toxic waste sites found, among other things, that "three out of every five [African-Americans] and Hispanic Americans lived in communities with uncontrolled toxic waste sites." *Id.*

14. *Id.*

15. See Lazarus, *supra* note 4, at 803. In response to the UCC and GAO findings, a group of academics and government officials held a conference in 1990 at the University of Michigan to discuss emerging environmental justice concerns. *Id.* The participants convinced EPA Administrator William K. Reilly to establish an EPA committee to audit the agency's policies from an environmental justice perspective. *Id.* at 803-04.

16. ENVTL. EQUITY WORKGROUP, OFFICE OF POLICY PLANNING AND EVALUATION, U.S. EPA, ENVIRONMENTAL EQUITY: REDUCING RISK FOR ALL COMMUNITIES, WORKGROUP REPORT TO THE ADMINISTRATOR (June 1992).

17. *Id.* at 13-14. The report cited four causes of greater minority exposure: 1) larger concentration of minorities in urban areas where emission densities tend to be greatest; 2) physical proximity of minority populations to hazardous waste sites; 3) minority consumption of contaminated food; and 4) minority farmworker exposure to pesticides. *Id.*

18. *Id.* at 11.

stringent environmental enforcement efforts in minority communities.¹⁹

Most recently, the Center for Policy Alternatives, the National Association for the Advancement of Colored People (NAACP), and the United Church of Christ released a report updating the 1987 UCC study.²⁰ The report concluded that environmental racism has worsened. For example, it found that minorities were forty-seven percent more likely than caucasians to live near a toxic waste site in 1993. Additionally, it noted that the percentage of minorities residing adjacent to toxic waste dumps increased from twenty-five percent in 1980 to nearly thirty-one percent in 1993.²¹

In response to public pressure arising out of these reports, the Clinton Administration issued an Executive Order in February of 1994 directing all federal agencies to address environmental justice in minority and low income populations.²² The Order calls for the creation of an Interagency Working Group on Environmental Justice to organize and coordinate agency activities.²³

In summary, although conclusive proof does not exist, sufficient evidence suggests that low income and minority communities bear a disproportionately higher burden of environmental hazards.²⁴ Completely redressing these inequities would require broad social changes in race and

19. Marianne Lavelle, *The Minorities Equation Race and Income: Variations on a Trend*, NAT'L L.J., Sept. 21, 1992, at S2. The study analyzed enforcement and waste statistics from civil enforcement cases on the EPA's Civil Enforcement Docket. Marianne Lavelle & Marcia Coyle, *Unequal Protection: The Racial Divide in Environmental law*, NAT'L L.J., Sept. 21, 1992, at S1. The study found race more significant than income in relation to fines and to the speed with which cleanup is initiated and completed. *Id.* Specifically, the study revealed that under all federal environmental laws targeting air, water, and waste pollution, penalties in predominately caucasian communities were 46 percent higher than in minority communities. *Id.* The average fine under the Resource Conservation and Recovery Act was \$335,566 in the areas with the greatest caucasian population compared to \$55,318 in the areas with the greatest minority population. *Id.*

20. *Enviro Justice: Report Finds Problem Has Got Worse*, GREENWIRE, Aug. 25, 1994, available in LEXIS, Nexis Library, Wire File. The study analyzed 530 commercial hazardous waste facilities using 1990 U.S. census data updated to 1993. *Id.*

21. *Id.* Charles Lee, the Director of the 1987 UCC Report, stated that the new study indicates "... a need for greater state involvement in buffering residents from the hazards of toxic sites." *Id.*

22. Executive Order No. 12,898, 49 C.F.R. 170 (1994). See also Gary Lee, *EPA: Clinton Executive Order Gives Boost to Mission*, WASH. POST, Feb. 17, 1994, at A21. The Executive Order requires federal agencies to determine whether their regulations adversely affect minorities or low income individuals. It also directs federal agencies to ensure that states or other organizations receiving federal funding for environmental projects do not violate federal civil rights laws. EPA Administrator Carol M. Browner has ordered EPA's general counsel to review agency regulations to determine whether they further environmental justice. *Id.*

23. Executive Order No. 12,898.

24. See *supra* notes 9-21 and accompanying text.

class relations. In the short term, however, state legislatures can try to solve the problem of distributional inequity by ensuring that waste facilities are sited in an equitable and non-discriminatory manner. The following section outlines the various approaches to state siting of waste facilities and the consequences of each from an environmental justice viewpoint.

III. CURRENT APPROACHES

State siting refers to the process of locating a hazardous waste facility. Four types of state siting approaches exist: super review, site designation, local control, or compensation.

A. Super Review Approach

The super review approach is the most commonly used state siting mechanism.²⁵ Under this approach, the prospective waste facility developer chooses a site and then applies to the state regulatory agency for a permit.²⁶ The agency evaluates the permit application according to criteria that vary from state to state.²⁷ In general, however, the agency will examine the facility's environmental impact and overall effect on the community. If the agency accepts the application, it passes it on to a special review board for further consideration.²⁸ These boards are usually composed of experts as well as local representatives.²⁹

The super review approach attempts to reach a fair result during the siting process by providing informed debate among the experts on the siting board.³⁰ It also enables local community members to participate in the decision-making. However, the super review model fails to ensure

25. For a detailed discussion of state hazardous waste programs using the super review approach see Rodolfo Mata, *Hazardous Waste Facilities and Environmental Equity: A Proposed Siting Model*, 13 VA. ENVTL. L.J. 375, 401-05 (1994); Bram D.E. Canter, *Hazardous Waste Disposal and the New State Siting Programs*, 14 NAT. RESOURCES LAW. 421, 438-443 (1982); Rachel D. Godsil, Note, *Remedying Environmental Racism*, 90 MICH. L. REV. 394, 403-408 (1991).

26. Godsil, *supra* note 25, at 403.

27. *Id.* at 404. Indiana, for example, requires developers to delineate the hydrogeological characteristics of the site as well as complete an environmental assessment and engineering plan. *Id.* Wisconsin, on the other hand, requires the developer to wait until the Department of Natural Resources has examined the site and determined its suitability in terms of topography, soils, geography, and hydrogeology. *Id.* Some states consider the effects of the site on the community as well. For example, Michigan assesses a site's impact on the scenic, historic, and recreational aspects of the area. *Id.*

28. *Id.*

29. *Id.* Experts include geologists, chemical engineers, academics, and state agency employees. Local representatives include anyone else representing the district. *Id.*

30. Canter, *supra* note 25, at 449.

environmental equity for two reasons. First, state siting statutes that use this approach often contain preemption clauses that allow the Board to make a decision contrary to the wishes of the affected community.³¹ Consequently, the siting board can still ignore local opposition if it so chooses. Second, this approach allows the developer to choose the proposed site. Naturally, developers have an economic incentive to choose sites with lower land values. Those sites are typically located in poor communities, especially poor, minority communities.³² Moreover, even when local land use laws preempt state siting statutes, more affluent communities can oppose a plan through litigation, political pressure, or civil disobedience.³³ Thus, in order to prevent delays and minimize expenses, developers ultimately pursue sites in the communities least able to muster opposition.³⁴

B. Site Designation

Under the site designation approach, the state, not the developers, compels a list of potential sites.³⁵ States utilizing this approach generally utilize a procedure in which affected local communities can communicate with the state regulatory authorities throughout the decision-making process.³⁶ On its face, site designation appears superior to super review because the state is better equipped to take a comprehensive view of site distribution and less likely to focus on profit.³⁷

However, site designation also has problems. Politicians representing

31. *Id.* at 450.

32. Godsil, *supra* note 25, at 399-400. African-Americans are more burdened by environmental risks because of segregated housing patterns. *Id.* at 399. Also, more so than African-Americans, poor caucasians tend to live in economically varied areas that benefit from the political clout of the middle class. *Id.* Conversely, black people are often concentrated in poverty areas. *Id.* Moreover, as a rule, caucasians are reluctant to move into a neighborhood that has a 20% African-American population. *Id.* at 400. Thus, these already poorer areas have a smaller pool of potential buyers, lowering housing prices and land values even further. *Id.* Lower land values are attractive to hazardous waste facility developers. *Id.*

33. *Id.* at 405.

34. *Id.*

35. Canter, *supra* note 25, at 443. Minnesota, Massachusetts, and Maryland utilize this approach. Their programs contain a common regulatory objective: to designate preferred sites for the construction of waste facilities prior to project proposals. *Id.*

36. *Id.* at 444-448. In Minnesota, for example, a resident from each host community serves as a temporary board member. *Id.* at 445. Maryland holds a public hearing in the area of the proposed site before the board makes a final decision on the certificate application. *Id.* at 444.

37. *But cf.* Mata, *supra* note 25, at 412 (arguing that states, just like private developers, are attracted to inexpensive property in order to make the most cost-effective use of limited resources).

more affluent and influential communities can lobby the agency to remove their districts from the site list.³⁸ In addition, in states such as Maryland where counties must designate suitable sites, the counties may purposely submit unsuitable sites or sites located within politically powerless communities.³⁹ This lessens the likelihood that the government will select a more affluent county as a site or at least ensures that any facility sited within the county will be located in a politically powerless community.⁴⁰

C. Local Control

Few states utilize the local control approach.⁴¹ Under this model, state siting statutes do not preempt local land use regulations.⁴² As a result, a local government can create narrow land use regulations to block the siting of facilities within its borders. This approach encourages the "Not in My Back Yard" (NIMBY) syndrome.⁴³ Thus, if a state requires a facility's siting, it must provide incentives to coax a local community into accepting the location. Lower income communities often need the benefits of state incentive programs. Thus, facilities often locate in less affluent areas.

D. Compensation Approach

In order to eliminate local opposition to sitings, some states have incorporated compensation schemes into their siting laws.⁴⁴ Compensation schemes attempt to redress the injustice inflicted up on communities required to cope with the burden of a waste facility. However, compensation programs can vary in several significant ways. First, compensation may serve as a remedy, a preventative measure, or a reward.⁴⁵ Second, compensation programs can differ as to timing. A community may receive compensation prior to the facility's construction, on an on-going basis, or

38. Godsil, *supra* note 25, at 406. (acknowledging the suggestion of other syndromes that may work against the pursuit of environmental equity including "Not In My Term Of Office" (NIMTOF) and "Not In My Election Year" (NIMEY)).

39. *Id.*

40. Mata, *supra* note 25, at 411.

41. These states are Florida and California. See Godsil, *supra* note 25, at 406-07.

42. *Id.* at 406.

43. *Id.* at 407. "Not in My Back yard" (NIMBY) is a popular acronym that refers to the public's opposition to the siting of undesirable land uses such as hazardous waste facilities. *Id.*

44. For an in-depth discussion of compensated siting proposals, see Vicki Been, *Compensated Siting Proposals: Is it Time to Pay Attention?*, 21 FORDHAM URB. L.J. 787, 788-96 (1994).

45. *Id.* at 792.

after the facility causes some harm.⁴⁶ Finally, compensation programs can differ as to the amount of compensation offered. Compensation may be determined by state statute, a state agency, or the parties themselves.⁴⁷ Thus, compensation systems may not effectively compensate a community for its waste facility costs.

A compensation scheme has other problems as well. Some environmental justice advocates have voiced moral objections to compensation for environmental hazards.⁴⁸ Others assert that compensation programs will ultimately fail because safety is not a negotiable issue.⁴⁹ One commentator has outlined four major questions regarding compensation proposals that require further exploration by those interested in environmental justice.⁵⁰ First, do compensation schemes subject to the marketplace matters such as health and safety, that should not be bought or sold.⁵¹ Second, because low-income communities are highly susceptible to accepting compensation programs, will such programs then lead to further distributional inequity and unfair treatment of the poor?⁵² Third, do compensation programs allow a community to enjoy the short-term economic rewards at the

46. *Id.* at 792-94. Compensation prior to a facility's construction generally takes the form of grants enabling communities to hire independent experts to evaluate the proposed facility. *Id.* at 793. Ongoing compensation may include special taxes or fees paid by the facility to the community, or services the facility provides the community such as jobs, boosts to the economy, or charitable contributions. *Id.* Compensation after the facility causes harm to the community is usually remedial in nature. *Id.* at 792. For example, it may require a developer to clean up existing waste sites in the community in exchange for permission to construct the new facility. *Id.* at 793.

47. *Id.* at 794-95.

48. See, e.g., ROBERT D. BULLARD, *DUMPING IN DIXIE: RACE, CLASS, AND ENVIRONMENTAL QUALITY* (1990).

49. Been, *supra* note 44, at 788 (citing Michael B. Gerrard, *Fear and Loathing in the Siting of Hazardous and Radioactive Waste Facilities: A Comprehensive Approach to a Misperceived Crisis*, 68 TUL. L. REV. 1047 (1994)); Bradford C. Mank, *The Two-Headed Dragon and Siting and Cleaning up of Hazardous Waste Dumps: Can Economic Incentives or Mediation Slay the Monster?*, 19. B.C. ENVTL. AFF. L. REV. 239, 275 (1991).

50. *Id.* at 824-26. Compensated siting proposals are widespread and here to stay for the foreseeable future. *Id.* at 824. Thus, the environmental justice movement must examine these proposals and formulate a more thoughtful and comprehensive position regarding such programs. *Id.*

51. *Id.* at 824-25. Been questions whether certain matters should not be traded on the market. *Id.* For example, society prohibits people from selling their kidneys to the highest bidder. *Id.* For a further discussion about whether certain rights should not be traded on the market, see Seth F. Kreimer, *Allocational Sanctions: The Problem of Negative Rights in a Positive State*, 132 U. PA. L. REV. 1293, 1389-90 (1984); Margaret J. Radin, *Market Inalienability*, 100 HARV. L. REV. 1849, 1903-37 (1987); Susan Rose-Ackerman, *Inalienability and the Theory of Property Rights*, 85 COLUM. L. REV. 931 (1985).

52. Been, *supra* note 44, at 824.

expense of the health of future generations?⁵³ Finally, because compensation programs are immoral unless entered into voluntarily, the parameters of such "voluntary" agreements must be delineated.⁵⁴

To date, traditional state siting approaches have failed to produce environmentally equitable results. For this reason, environmental justice advocates in several states are now pressuring legislators to reform state siting processes to account for the distributional inequities inherent in present siting approaches.

IV. ARKANSAS' ENVIRONMENTAL EQUITY ACT

Act 1263 of 1993⁵⁵ is the first and most substantive "environmental equity" legislation passed in the nation.⁵⁶ The Act creates a rebuttable presumption against permitting⁵⁷ the construction or operation of a high impact, solid waste management facility⁵⁸ within twelve miles of an existing high impact solid waste management facility.⁵⁹ The Department of Pollution Control and Ecology, the regional or service area solid waste planning board, and any other governmental body possessing the authority to grant or zone jurisdiction over a facility, must honor this presumption.⁶⁰

But, a prospective owner can rebut the presumption by showing that no other suitable site exists in the region because of geographical constraints

53. *Id.* at 825. For a discussion of the nature of our obligation to future generations see Daniel A. Farber & Paul A. Hemmersbaugh, *The Shadow of the Future: Discount Rates, Later Generations, and the Environment*, 46 VAND. L. REV. 267, 289-300 (1993).

54. *Been*, *supra* note 44, at 825 (questioning whether an agreement is truly voluntary if communities are ignorant, relative to site developers, of the risks and harms the facility will impose).

55. Siting High Impact Solid Waste Management Facilities Act of Apr. 20, 1993, No. 1263 (codified at ARK. CODE ANN. § 8-6-1501-1504 (Michie 1993)).

56. ARK. CODE ANN. § 8-6-1501(b) (Michie 1993). In the Act's section on legislative intent, the General Assembly explicitly states that it enacted this section in response to the proliferation of solid waste disposal facilities in lower income and minority communities. See *supra* note 3 and accompanying text.

57. "'Permitting' means any governmental authorization to proceed with construction or operation of a facility or activity required by either state law or local ordinance." ARK. CODE ANN. § 8-6-1502(2) (Michie 1993).

58. A "high impact solid waste management facility" is "any solid waste landfill, any solid or commercial hazardous waste incinerator, and any commercial hazardous waste treatment, storage or disposal facility." *Id.* at § 8-6-1502(1)(A).

This definition does not include "(i) recycling or composting facilities; (ii) waste tire management sites; (iii) solid waste transfer stations; or (iv) solid waste landfills which have applications pending for either increased or new acreage or provisions for additional services or increased capacity." *Id.* at § 8-6-1502(1)(B).

59. *Id.* at § 8-6-1504(a)(1).

60. *Id.* at § 8-6-1504(a)(2).

or that the host community⁶¹ has accepted the siting in return for certain incentives.⁶² These incentives may include increased employment opportunities, reasonable host fees, contributions to the community infrastructure, compensation to any adjacent landowners, or the subsidization of local community service.⁶³ The Department of Pollution Control and Ecology can not process those permit applications subject to the rebuttable presumption until the affected community authorities have issued definitive findings regarding the necessary conditions for the permit.⁶⁴

A. *Comparison to Other Legislative Proposals*⁶⁵

1. *State Legislation*

Besides Arkansas, four states have enacted environmental justice legislation.⁶⁶ However, each of these statutes generally does nothing more than mandate some form of information gathering and analysis. Florida⁶⁷ requires the creation of an Environmental Equity and Justice Commission to examine the distribution of environmental hazards and to assess and make recommendations as to how Florida can best address any environmental inequities found.⁶⁸

61. "Host community" means "all governmental units possessing zoning authority encompassed within a twelve-mile radius of the site of a proposed high impact solid waste management facility." *Id.* at § 8-6-1502(3).

62. The Act does not address who decides whether the presumption has been adequately rebutted.

63. ARK. CODE ANN. 8-6-1504(b)(2)(A)-(E).

64. *Id.* at § 8-6-1503.

65. For a general description of state environmental justice legislation and legislative proposals, see BARTON HACKER, CENTER FOR POLICY ALTERNATIVES, ENVIRONMENTAL JUSTICE: LEGISLATION IN THE STATES (Barbara Butler ed., 1994).

66. See *infra* notes 67-73 and accompanying text.

67. FLA. STAT. ANN. § 760.85 (West 1994).

68. *Id.* The commission is required to submit a report by December 31, 1995 that includes 1) a listing of the major targeted sites, with past and current demographic information, including health statistics of the surrounding population; 2) a review of past enforcement actions; 3) review of factors, including economic factors, that may have caused the concentration of sites; 4) a review of state statutes, rules, and policies, and a review of the role played by state, regional, and local governmental entities in siting and land use decisions; 5) a review of data and methodologies which can increase awareness of neighborhoods with high risk for health effects; 6) a review of enforcement statutes and rules; 7) a review of government efforts at every level to ensure equitable representation of minority and low income communities in the government work force; 8) a review of EPA methods used to communicate with minority and low income communities; 9) a review of approaches to ensure consideration of environmental equity issues when formulating agency policies; and 10) an analysis of the creation of a permanent institutional review entity to deal with environmental equity. *Id.*

For a further discussion of the statute, see Hacker, *supra* note 65, at 5 (noting that the Florida

Similarly, Louisiana law requires the state to hold at least three fact-finding hearings to gather facts and obtain comments concerning environmental equity.⁶⁹ But, as of August 24, 1994, the Louisiana Department of Environmental Quality (DEQ) had simply completed the hearings process and issued a Report which included several recommendations regarding legislation, funding, and DEQ reporting.⁷⁰

Tennessee and Virginia both passed House Joint Resolutions concerning environmental equity. Tennessee requires the Commissioners of Health and Environment to analyze a hypothetical Environmental Justice Act patterned after federal legislation.⁷¹ The most significant aspect of the hypothetical act requires a moratorium on new facilities when a significant adverse effect on human health is disclosed in high impact areas.⁷² Virginia requires a review commission to study the siting, monitoring, and clean-up of solid and hazardous waste facilities, emphasizing their impact on minority communities.⁷³

legislation passed with little opposition due to the fact that it mandated only information gathering rather than specific recommendations).

69. 1993 La. Act 767 (codified as LA. REV. STAT. ANN. §§ 30:2011(D)(5), 2074(B)(1) (West 1993)).

70. Hacker, *supra* note 65, at 9-10. Specific recommendations include:

- 1) strengthening land use planning requirements in the state;
- 2) strengthening the regulations regarding the transportation of toxic materials;
- 3) providing tax incentives to reduce the generation of hazardous waste in Louisiana;
- 4) strengthening statutes pertaining to emergency response situations in order to meet the needs of adjacent communities;
- 5) providing funding to the DEQ to expand the Environmental Justice Program, establish a community/industry environmental justice panel, develop a joint project to train citizens in emergency responses, and to aid Historically Black Universities in the state in developing support programs which would increase the amount of minority candidates qualified for positions at the DEQ; and
- 6) requiring DEQ to report to the legislature on modified public notification procedures, on the annual status and progress of the Environmental Justice Program, and to review enforcement alternatives in this area.

Id.

71. HACKER, *supra* note 65, at 21 (citing House Joint Resolution 146 (1993) and describing it as designed to pave the way for a state bill modeled after former Senator Al Gore's federal legislation).

72. *Id.*

73. HACKER, *supra* note 65, at 23 (citing Virginia Joint House Resolution 529 (1993) and describing it as a model for future environmental justice legislation).

2. *State Legislative Proposals*⁷⁴

Several states have recently introduced environmental justice bills. Although all were defeated, most will be reintroduced in the 1995 legislative session. The most notable bills, introduced in Georgia, South Carolina, New York, and California, go beyond mere information gathering and provide specific regulation.

Georgia's House Bill 368⁷⁵ instructs the Director of the Environmental Protection Division of the Department of Natural Resources to identify the 100 counties with the highest total weight of toxic chemicals and designate them high-risk areas.⁷⁶ The Director must then issue a report identifying the nature and extent of the impacts on human health in these high-risk areas and compare them with other counties.⁷⁷ If the director reports significant adverse impacts on health, the state will impose a moratorium on the siting of any new facility in that area.⁷⁸

South Carolina House Bill 3824⁷⁹ takes a somewhat different approach.

74. There are also several federal environmental justice bills pending in Congress. Although an in-depth discussion of these proposals is beyond the scope of this note, a brief capsule of these proposals may be useful. The Environmental Equal Rights Act, H.R. 1924, 103d Cong., 1st Sess. (1993), would enable a citizen petitioner to challenge the construction of a waste facility by showing that the proposed facility would be located in an environmentally disadvantaged community and that it may adversely affect the human health or the environment of the community.

The Environmental Health Equity Information Act, H.R. 1925, 103d Cong., 1st Sess. (1993), seeks to amend the Comprehensive Environmental Response, Compensation, and Liability Act of 1990 (CERCLA) and require the collection of information regarding the race, age, gender, ethnic origin, and income level of persons living in communities adjacent to toxic substance contamination.

The Environmental Justice Act of 1993, H.R. 2105, 103d Cong., 1st Sess. (1993), requires information gathering to identify and rank environmental high impact areas. Moreover it provides technical assistance grants and calls for a moratorium on siting in communities already overloaded with multiple polluting sources.

The Public Health Equity Act of 1994, S. 1841, 103d Cong., 1st Sess. (1993), prohibits discrimination on the basis of race, color, or national origin in programs and activities relating to exposure to hazardous substances.

75. HACKER, *supra* note 65, at 7 (describing and setting forth Georgia house Bill 368, the Environmental Justice Act of 1993).

76. *Id.*

77. *Id.*

78. *Id.* Ga. H.B. 368 died in the House Committee on Natural Resources and Environment because of opposition from many large special interest groups. However, H.B. 368 may yet pass. An Environmental Justice Act is one of the Georgia Black Caucus' top priorities in 1995. *Id.* In addition, Environmental Justice grassroots activists have increased awareness of the issue which promises to increase the pressure on Georgia state legislators in 1995. *Id.* at 8.

79. HACKER, *supra* note 65, at 19 (summarizing South Carolina's Environmental Equity Act, South Carolina House Bill 3824 (1994)).

It too calls for the identification of environmental high impact areas.⁸⁰ If the Department of Health and Environmental Control discovers adverse health impacts in those areas, the state will impose a moratorium on future sitings. In addition, the bill authorizes a toxic chemical user fee for facilities located in these areas.⁸¹ Revenue generated by these user fees would enable individuals, citizen groups, and government agencies in the high-risk area to obtain an independent impact study on the effects of the facility, thus facilitating local, informed participation in the process.⁸²

The legislation proposed in New York and California would focus on regulating permit applicants. California Assembly Bill 2212⁸³ requires permit applicants to include a description of the project site demographics.⁸⁴ Similarly, New York Assembly Bill 7140⁸⁵ requires the permit applicant to submit a plan outlining an economic development strategy to reduce unemployment or poverty rates in any economically distressed community selected as a facility location.⁸⁶

B. Analysis

A realistic and workable solution to siting dilemmas can not evolve without state experimentation. Thus, although this Recent Development raises concerns about aspects of both Arkansas' law and other states' proposals, these models serve as positive steps towards achieving environmental justice.

Arkansas' "Environmental Equity Act" utilizes a version of the local control approach combined with compensation or incentive mechanisms.⁸⁷ Affected communities may choose whether to block the proposed siting by

80. *Id.*

81. *Id.*

82. *Id.* S.C. H.B. 3824 died in the House Agriculture, Natural Resources & Environmental Affairs Committee. According to Van Heggler, Director of Research for this Committee, the bill died for two reasons. First, business interests were adamantly opposed to the bill. *Id.* Second, there was a lack of interaction and united support behind the bill from environmental and grassroots communities. *Id.* at 20

83. Cal. A.B. 2212 (1993).

84. HACKER, *supra* note 65, at 3. The issues raised in Cal. A.B. 2212 have been raised on two prior occasions. On each occasion, the bill passed the legislature but was subsequently vetoed by Governor Pete Wilson, who believes that the bill will burden the state's businesses. *Id.*

85. HACKER, *supra* note 65, at 16 (summarizing New York Assembly Bill 7140 (1994)).

86. *Id.*

87. ARK. CODE ANN. S8-6-1501. The statute actually employs a unique version of the local control method because only communities with an existing solid waste management facility have the authority to say "Not In My Backyard".

withholding their consent, or to accept the facility in return for compensation.⁸⁸ Thus, Arkansas' approach empowers communities which have been politically powerless in the past and gives them control over their neighborhoods.⁸⁹

However, Arkansas' approach raises several concerns. First, the statute does not specify what resources the community has to make an educated evaluation of the proposed facility. While they may certainly rely on personal experiences, affected communities are entitled to more information. Charlotte Bullock of South Central Los Angeles states her reliance on personal experience succinctly: "The [L.A. City] Council is going to build something in my community which might kill my child...I don't need a scientist to tell me that's wrong."⁹⁰ However, personal experience may, at times, be insufficient. If targeted communities are making acceptance decisions without full and accurate knowledge of the risks and harms involved, questions of fairness and morality arise.

Even if communities understand the risks, Arkansas' approach raises the additional concern that the poorest communities will sacrifice health and safety for economic gain.⁹¹ In fact, the Arkansas' Act has not thus far served as an effective barrier to the siting of facilities in less affluent neighborhoods. Rather host communities have accepted them in exchange for promises of jobs and economic development.⁹² Finally, Arkansas' approach allows communities to trade away the rights of future generations not represented in the decision-making process.⁹³

In summary, community empowerment, that provides the affected community with full and accurate knowledge of the risks involved, is a

88. See *supra* notes 55-64 and accompanying text.

89. Some commentators have argued that "community empowerment" is a necessary prerequisite to achieving environmental justice and that the "mainstream" environmental movement must encompass this type of grassroots environmentalism in order to evolve equitably. See Luke W. Cole, *Empowerment as the Key to Environmental Protection: The Need for Environmental Poverty Law*, 19 *ECOLOGY L.Q.* 619, 639-41 (1992). The only way to achieve a more equitable distribution of environmental risks is through community empowerment at the grassroots level. *Id.* at 657-58. The decision to site a facility is a political and economic one. *Id.* Thus, legal strategies are doomed to fail because they do not alter the political and economic power relations in the community that spawned the environmental threat. *Id.* Cole points to the failures of the civil rights laws to end racism evidence that these same laws are inadequate to address environmental equity issues. *Id.* at 647-48.

90. *Id.* at 662-63 ("... [P]eople who actually bear the burden of pollution are experts in their own right: ... [Their] experiences are as valid, or more valid, than those of the traditional experts.")

91. See *supra* note 52 and accompanying text.

92. HACKER, *supra* note 65, at 2. (citing statement of Mike Hood, Arkansas Pollution Control and Ecology Department, Solid Waste Division).

93. See *supra* note 53 and accompanying text.

positive step towards combating environmental inequity. Communities in Arkansas that do not want waste facilities can keep them out. The concern remains, however, that even with full knowledge, some communities may be forced to sacrifice present and future health for immediate economic relief.

In contrast, the majority of the other states' proposals adopt a super review or site designation approach. Georgia and South Carolina, for example, would ultimately place the siting decision in the hands of the state government, although the state would encourage locally affected communities to participate in the decision-making process.⁹⁴ These methods place a higher priority on state guidance than on community empowerment. The problem with these proposals is that if the state decides that siting the facility would not significantly impact human health, the community becomes burdened with the site without the benefit of a compensation package.⁹⁵

IV. RECOMMENDATIONS

Acknowledging that political opposition is a formidable barrier to environmental justice legislation, this Recent Development attempts to outline a proposed model of state legislation with the greatest potential for achieving environmental equity.

Arkansas' legislation rests on the solid premise that siting decisions are inherently more just when the affected community controls the outcome. Working from this premise, Arkansas' legislation could be strengthened in a number of ways.

A. *Assure Informed Consent*

A community cannot voluntarily enter into a siting agreement if it does not fully understand the risks and harms involved. In order to ensure complete and accurate knowledge, model state legislation should include a mechanism that provides affected communities with funds enabling them to conduct independent health and safety analyses. Two potential sources exist for these funds. First, state legislation could include a provision similar to South Carolina's proposed legislation, authorizing a toxic

94. See *supra* notes 75-82 and accompanying text, discussing Georgia and South Carolina's bills.

95. Cf. New York Assembly Bill 7140 (1994) (employing a super review approach with a built in compensation scheme that requires developers to submit an economic development strategy in an effort to reduce unemployment and poverty rates within the affected community).

chemical user fee.⁹⁶ The state could set aside the funds raised by these user fees for local communities to obtain independent impact studies. Alternatively, the state could require the developer negotiating with the community over the proposed facility to pay for an independent study.⁹⁷

B. Fair Negotiation

In addition to full and accurate information, model state legislation should include a mechanism ensuring that the affected community receives a fair compensation package. To achieve this end, the state should create some form of environmental equity siting board.⁹⁸ This entity would act as a clearinghouse for siting agreements by giving local communities access to the terms and the result of siting agreements negotiated by other communities.⁹⁹ The board would also provide local communities access to other compensation packages negotiated by the particular developer.¹⁰⁰ This will help equalize the parties' respective bargaining power because communities will then have insight into what the developer has given in the past.

C. Intergenerational Equity

Even with informed consent and fair negotiation, the risk remains that communities will choose economic benefits over risks that could affect

96. See *supra* note 81 and accompanying text.

97. Been, *supra* note 44, at 793. Compensation prior to construction often takes the form of grants given by developers to the host community to hire its own expert to evaluate the proposed facility. Others, however, have proposed that developers of waste facilities offer to clean up all or some of a community's existing sites in exchange for approval of the proposed facility. *Id.* (citing Kent E. Portnoy, *Siting Hazardous Waste Treatment Facilities: The NIMBY Syndrome*, 137-59 (1991)).

98. Ideally, the siting board should be as non-political as possible. Members should include academics in the areas of public health, city planning, and law, along with geologists, chemical engineers, state agency persons, and local representatives from across the state. Most importantly, the board should strive to insure that local representatives embody a diverse cross section of racial and socioeconomic groups.

The means by which board members are selected will undoubtedly impact the board's neutrality. If members are chosen by state representatives, the danger remains that they may act as a proxy for politicians from more affluent areas and attempt to pressure poorer communities into accepting environmental hazards. No solution is free from any danger of unfair political influence. However, the risk is minimized when the Board acts as an advisor rather than decisionmaker. The Board's decision-making power should be limited to preventing communities from hosting too many facilities. See *infra* note 101 and accompanying text.

99. Been, *supra* note 44, at 825. There is little research on how siting agreements have worked out in practice. *Id.*

100. *Id.* Industries would be prohibited from imposing, as a condition to the compensation agreement, the condition that the community not reveal its terms.

future generations. To prevent such an outcome, model legislation should include a provision whereby the state environmental equity siting board can intervene and place a moratorium on the siting of new facilities in an area it deems overburdened. The board would conduct regular inspections and impact studies in environmental high impact areas. If the Board found significant impacts on human health, it would impose a moratorium.¹⁰¹ This way the board would act not only as a clearinghouse for information but also as a watchdog for future generation's.

V. CONCLUSION

There is no quick-fix solution to the distributional concerns raised by the generation and consequent disposal of toxic and hazardous wastes. No one wants a toxic waste site in their community. However, as long as industries produce hazardous wastes, a system for the equitable distribution of waste facilities must be developed. So far, the evidence strongly suggests that poor and minority communities disproportionately bear the burden of environmental hazards. In order to reverse this trend, state legislatures can and must reform their siting practices to produce more equitable results. A workable solution to siting dilemmas necessitates state experimentation. This Recent Development has attempted to outline a framework upon which state legislatures can build, emphasizing local community empowerment, adequate resources to assure informed consent and safety mechanisms to protect both current and future generations.

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101. The board's power would be limited to preventing a community from hosting too many sites. This model differs from both the super review and site designation approaches in that the board would neither make the ultimate siting decision nor create any inventory of potential sites. This eliminates the risk that board members would approve a site over local opposition as well as the risk that politicians from affluent communities would be able to lobby the board to remove their district from any inventory list.

DIRECTOR LIABILITY AND THE INSOLVENT, FEDERALLY CHARTERED FINANCIAL INSTITUTION: A STANDARD EMERGES

This Recent Development discusses the standard of liability for directors and officers¹ of failed, federally chartered financial institutions. In particular, it focuses on the effect the Financial Institution Reform, Recovery and Enforcement Act (FIRREA)² has on the standard of liability when a federally chartered institution operates in a state which provides a cause of action for simple negligence.³ Although federal regulators can sue directors of state chartered institutions under state law standards,⁴ controversy exists over whether state law simple negligence standards apply to directors of federally chartered institutions after FIRREA.

The Seventh Circuit recently addressed this issue in *Resolution Trust Corp. v. Chapman*.⁵ A divided court concluded that, federal regulators could not sue the directors of failed, federal institutions under state simple negligence standards.⁶ Rather, the directors were held to the FIRREA's less stringent gross negligence standard.⁷

Part I of this Recent Development discusses the corporate and legal climate that prompted Congress to pass FIRREA. Part II examines the text and history of FIRREA and cases interpreting the statute's liability provisions. Part III analyzes the *Chapman* decision. Finally, this Recent Development examines how *Chapman* frustrates congressional intent by insulating directors of federally chartered institutions from liability and by

1. The remainder of this note will refer only to directors. Such references include officers as well.

2. Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified in scattered sections of the U.S.C.A.).

3. This Recent Development is limited to discussing the propriety of applying state law standards of liability to the directors of insolvent, federally chartered financial institutions. FIRREA authorizes federal regulatory agencies to assert the claims of an institution against the institution's directors only after the institution has been placed into receivership or conservatorship. See 12 U.S.C. § 1821(d)(2)(A) (Supp. V 1993). Therefore, the issues raised by director liability actions prior to insolvency are beyond the scope of this Recent Development. Moreover, this Recent Development does not focus on the application of state law standards to state chartered institutions. For a discussion of state law standards and the state chartered institution, see Jon Shepard, Note, *The Liability of Officers and Directors Under the Financial Institutions Reform, Recovery and Enforcement Act of 1989*, 90 MICH. L. REV. 1119 (1992).

4. See *FDIC v. McSweeney*, 976 F.2d 532 (9th Cir. 1992), cert. denied, 113 S. Ct. 1440 (1993); *FDIC v. Canfield*, 967 F.2d 443 (10th Cir.), cert. dismissed, 113 S. Ct. 516 (1992).

5. 29 F.3d 1120 (7th Cir. 1994).

6. *Id.* at 1123.

7. *Id.*

decreasing a state's power to regulate corporate activity within its borders.

I. DIRECTOR LIABILITY AND THE NEED FOR FEDERAL INTERVENTION

Courts reviewing the actions of directors of financial institutions rarely impose personal liability on directors.⁸ Rather, these directors fall under the protection of the business judgement rule.⁹ This rule arose out of a concern for judicial competence in business affairs¹⁰ and the need for directors to have the freedom to take risks in the interests of their businesses.¹¹ Under the business judgement rule, courts are reluctant to second guess management decisions.¹² Rather, courts have developed a uniform standard of liability whereby, in the absence of a conflict of interest transaction,¹³ a director does not face personal liability for management decisions unless grossly negligent in failing to gather all relevant information before making a business decision.¹⁴

8. See *Joy v. North*, 692 F.2d 880, 885 (2d Cir. 1982) ("A corporate officer who makes a mistake in judgement as to economic conditions, consumer tastes or production line efficiency will rarely, if ever, be found liable for damages suffered by the corporation."), *cert. denied*, 460 U.S. 1051 (1983).

9. "The 'business judgment' rule sustains corporate transactions and immunizes management from liability where the transaction is within the powers of the corporation (*intra vires*) and the authority of management, and involves the exercise of due care and compliance with applicable fiduciary duties." HARRY G. HENN & JOHN R. ALEXANDER, *LAW OF CORPORATIONS* § 242 (3d. ed. 1983). See also American Law Institute, *Principles of Corporate Governance* § 4.01 (1994) (stating suggested statutory codification of the business judgment rule, with annotations).

10. See *North*, 692 F.2d at 886. The *North* court discussed the limitations of the judicial process in areas of business, noting that: "[C]ourts recognize that after-the-fact litigation is a most imperfect device to evaluate corporate business decisions. The circumstances surrounding a corporate decision are not easily reconstructed in a courtroom years later, since business imperatives often call for quick decisions, inevitably based on less than perfect information." *Id.*

11. In explaining the value of risk-taking by a corporate enterprise, the *North* court stated: "[B]ecause potential profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law not create incentives for overly cautious corporate decisions. Some opportunities offer great profits at the risk of very substantial losses, while the alternatives offer less risk of loss but also less potential profit.

Id.

12. See *id.* at 885-86.

13. When a director uses his corporate position to further personal rather than corporate interests, the transaction is said to be a conflict of interest transaction violative of the director's fiduciary duty of loyalty. See HENN & ALEXANDER, *supra* note 9, § 238. The director may be held personally liable to the corporation for any damages arising from the transaction. *Id.* This Recent Development is limited in scope to the potential liability arising from a director's violation of the fiduciary duty of care.

14. Two prominent Delaware director liability cases illustrate the prevailing standard of care that developed under the business judgement rule. *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985) ("We think the concept of gross negligence is also the proper standard for determining whether a business judgement reached by a board of directors was an informed one."); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) ("While the Delaware cases use a variety of terms to describe the applicable

Despite the apparent safe harbor that a gross negligence standard of liability imparts, in *Smith v. Van Gorkom*¹⁵ the Delaware Supreme Court indicated a willingness to find directors liable under this standard.¹⁶ While the facts in *Van Gorkom* arguably rose to the level of gross negligence in light of the lack of information gathered by the board prior to approving a major transaction,¹⁷ the decision nonetheless frightened directors and caused states to reassess their approach to director liability.¹⁸

Many states continue to hold directors to the standard of care that an ordinarily prudent person would exercise in a similar situation.¹⁹ The *Van Gorkom* decision led many other states to enact statutes designed to reduce or eliminate a director's risk of liability and to extend the protection the Delaware Supreme Court appeared unwilling to offer.²⁰ Although some states provide that only intentional or reckless conduct will lead to liability, others permit shareholders to entirely limit or eliminate a director's personal liability.²¹ The states that shield directors beyond the protection

standard of care, . . . under the business judgement rule director liability is predicated upon concepts of gross negligence.”).

15. 488 A.2d 858.

16. *Id.* at 893.

17. See *id.* at 874; see also Andrew G.T. Moore II, *The 1980s—Did We Save the Stockholders While the Corporation Burned?*, 70 WASH. U. L.Q. 277, 281 (1992). Justice Moore, who joined the majority opinion in *Van Gorkom*, explains that the decision did not create new law. Rather, he notes, the court applied “well-established principles to egregious facts.” *Id.* at 281.

18. See Stephen A. Radin, *The Director's Duty of Care Three Years After Smith v. Van Gorkom*, 39 HASTINGS L. J. 707, 709 (1988) (analyzing post-*Van Gorkom* decisions and state legislative efforts to address director liability).

19. “Thirty-eight jurisdictions require that a director of a corporation discharge the duties of his office [with] . . . the care that an ordinarily prudent person would exercise under similar circumstances.” 2 MODEL BUSINESS CORP. ACT ANN. § 8.30 annot. (3d ed. 1993) (statutory comparison); see, e.g., REV. MODEL BUS. CORP. ACT § 8.30(a)(2) (1994); CONN. GEN. STAT. ANN. § 33-313(d) (West Supp. 1994); MICH. COMP. LAWS § 450.1541a(1) (1993); MISS. CODE ANN. § 79-4-8.30 (Supp. 1994); NEB. REV. STAT. § 21-2035 (1991); N.H. REV. STAT. ANN. § 293-A:8:30 (Supp. 1994); N.C. GEN. STAT. § 55-8-30(a) (1990).

20. See James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207, 1209-10 (1988) (noting that since the year the Delaware Supreme Court decided *Van Gorkom*, more than forty states “have adopted some form of legislation designed to reduce the risk of directors’ personal liability for money damages.”).

21. See Shephard, *supra* note 3, at 1120 n.7 (citing ALASKA STAT. § 10.06.210(1)(N) (1989)); ARIZ. REV. STAT. ANN. § 10-054(A)(9) (1990) (permitting shareholders to limit or eliminate director liability); ARK. CODE ANN. § 4-27-202(B)(3) (Michie Supp. 1991); CAL. CORP. CODE § 204(a)(10) (1990) (shareholder power to limit eliminate director liability); COLO. REV. STAT. § 7-3-101(u) (Supp. 1991) (shareholder power to limit or eliminate liability); DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1991) (shareholder power to limit or eliminate director liability); GA. CODE ANN. § 14-2-202(b)(4) (Michie 1989); HAW. REV. STAT. § 23-415-48.5 (Supp. 1991); IDAHO CODE § 30-1-54(2) (Supp. 1991); IND. CODE ANN. § 23-1-35-1(e) (West Supp. 1991) (precluding director liability unless conduct

provided by the previously impenetrable gross negligence standard set the stage for directors to act with presumed impunity.

This presumed impunity appeared most acute in the management of America's financial institutions.²² In addition to effectively being shielded from liability by the statutes of several states, directors of financial institutions enjoyed the added protection of federally insured operating capital²³ and the simultaneous deregulation of the banking industry.²⁴

"constitutes willful misconduct or recklessness"); IOWA CODE ANN. § 490.832 (West 1991); KAN. STAT. ANN. § 17-6002(b)(8) (1988); KY. REV. STAT. ANN. § 271B.2-020(2)(d) (Michie 1989); LA. REV. STAT. ANN. § 12:24(c)(4) (West Supp. 1991); ME. REV. STAT. ANN. tit. 13-A, § 716 (West Supp. 1991); MD. CORPS. & ASSNS. CODE ANN. § 2-405.2 (Supp. 1991); MASS. GEN. L. ch. 156B, § 13(b)(1) (1988); MICH. COMP. LAWS ANN. § 450.1209(c) (West 1990); MINN. STAT. ANN. § 302A.251(4) (West Supp. 1992); NEB. REV. STAT. § 21-2035(2) (Supp. 1990); NEV. REV. STAT. § 78.037(1) (1991); N.H. REV. STAT. ANN. § 293-A:54(I-a) (Supp. 1991); N.J. STAT. ANN. § 14A:2-7(3) (West Supp. 1991); N.M. STAT. ANN. § 53-12-2(E) (Michie Supp. 1991); N.Y. BUS. CORP. LAW § 402(b) (McKinney Supp. 1992); N.C. GEN. STAT. § 55-2-02(b)(3) (1990); OKLA. STAT. ANN. tit. 18, § 1006(B)(7) (West Supp. 1992); OR. REV. STAT. § 60.047(2)(c) (1989); R.I. GEN. LAWS § 7-1.1-48(a)(6) (Supp. 1991); S.C. CODE ANN. § 33-2-102(e) (Law. Co-op. 1990); S.D. CODIFIED LAWS ANN. § 47-2-58.8 (1991); TENN. CODE ANN. § 48-12-102(b)(3) (Supp. 1991); TEX. REV. CIV. STAT. ANN. art. 1302-7.06(B) (West Supp. 1992); UTAH CODE ANN. § 16-10-49.1 (1991); WASH. REV. CODE § 23B.08.320 (1989); WIS. STAT. ANN. § 180.0828 (West Supp. 1991); WYO. STAT. § 17-16-834 (1989); see also OHIO REV. CODE ANN. § 1701.59(D) (Anderson 1992) (providing for director liability only when director's "action or failure to act involved an act or omission undertaken with deliberate intent to cause injury to the corporation or undertaken with reckless disregard for the best interests of the corporation.").

22. For a thorough discussion of the mismanagement of financial institutions during the latter part of the 1980s, see David B. Fischer, Comment, *Bank Director Liability Under FIRREA: A New Defense for Directors and Officers of Insolvent Depository Institutions—Or a Tighter Noose?*, 39 UCLA L. REV. 1703, 1706-07 (1992). Fischer explains:

Of the many causes contributing to the depository institution crisis, substantial attention focused on the misdeeds perpetrated by some bank and thrift directors . . . One savings and loan scandal, focusing on a thrift director's efforts to "buy friends in Washington," implicated five United States Senators. . . . The director of one failed institution was accused of spending \$850,000 of his thrift's funds to acquire "the world's foremost collection of magic-related books, artifacts and artwork," according to regulators. Another was charged with squandering his thrift's assets on prostitutes, beach houses, and a yacht. The excesses covered the proverbial sublime-to-ridiculous range.

Id. (footnotes omitted).

23. See 12 U.S.C. § 1811(a) (1988) (creating the Federal Deposit Insurance Corporation (FDIC) and providing that the FDIC "shall insure. . . the deposits of all banks and savings associations which are entitled to the benefits of insurance under this chapter"); see also John M. Berry and Kathleen Day, *High Stakes as Banks Shed Reins; Taxpayers' Liability, Customers' Service at Risk*, WASHINGTON POST July 26, 1987, at H1 (questioning the wisdom behind deregulating an industry whose major source of money is insured by the federal government).

24. For a discussion of the deregulation of the banking industry and the commensurate expansion of savings institutions' powers in the 1980s, see 1 MICHAEL P. MALLOY, *THE CORPORATE LAW OF BANKS: REGULATION OF CORPORATE AND SECURITIES ACTIVITIES OF DEPOSITORY INSTITUTIONS* § 1.2 (1988) (noting that since 1980, the powers of savings and loans has been expanded dramatically). See also Douglas Frantz and Tom Furlong, *Contagion of Ailing S&L's Poses Threat to Entire Thrift*

This degree of protection facilitated flagrant mismanagement of the industry.²⁵ When federal banking agencies²⁶ sought to curb this mismanagement, the same state statutes that stimulated the director's mismanagement in the first instance rendered the agencies' attempts to redress the situation futile.²⁷ Congress responded by enacting the FIRREA, which allows federal intervention into the field of corporate governance, an area traditionally governed by state law.²⁸ Unfortunately, the scope and effect of this intervention remains uncertain.

II. FIRREA: MAKING DIRECTOR LIABILITY MORE STRINGENT

In response to state laws that insulated directors from liability, Congress enacted FIRREA in 1989.²⁹ In passing FIRREA, Congress sought to strengthen the power of federal regulators³⁰ and to curtail activities that placed federal insurance funds at risk.³¹ To accomplish these objectives, Congress needed to overcome the barriers to director liability imposed by the recently enacted state legislation.³² Therefore, Congress enacted

Industry, L.A. TIMES, Jan. 3, 1988, at 1 ("The savings and loan business has been in trouble ever since [the 1980s] began . . . at first suffering huge losses sparked by soaring interest rates and later from poor quality lending that was aided by bank deregulation. . .").

25. See *supra* note 22.

26. The main federal regulatory bodies charged with policing the actions of financial institutions are the FDIC and the Resolution Trust Corporation (RTC). Congress has empowered the FDIC to operate as a receiver and as a conservator, succeeding to any claims the shareholders may have had against the institution's directors. 18 U.S.C. § 1821(c),(d)(1) (Supp. V 1993). Pursuant to FIRREA, Congress created the RTC as an instrument of the United States, with powers similar to the FDIC regarding receivership and conservatorship. 12 U.S.C. § 1441a(b)(1) (Supp. V 1993).

27. In explaining an amendment to an early draft of FIRREA, Senator Reigle, Chairperson of the Senate Banking Committee, expressed concern that "many states have enacted legislation that protects directors and officers of companies from damage suits." 135 CONG. REC. S4278 (daily ed. April 19, 1989).

28. See Cindy A. Schipani, *Should Bank Directors Fear FIRREA: The FDIC's Enforcement of the Financial Institutions Reform, Recovery and Enforcement Act*, 17 J. CORP. L. 739, 741 (1992).

29. FIRREA, Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified in various sections of the U.S.C.).

30. FIRREA, Pub. L. No. 101-73, §101(9), 103 Stat. 183, 187 (1989) (codified at 12 U.S.C. § 1811 (note) (Supp. V 1993)).

31. FIRREA Pub. L. No. 101-73, 101(3), 103 Stat. 183, 187 (1989) (codified at 12 U.S.C. § 1811 (note) (Purposes of 1989 Amendment) (Supp. V 1993)).

32. FIRREA's legislative history makes it clear that the means by which the statute empowers federal regulators and protects federally insured deposit funds involves preempting the state legislation that made it difficult or impossible to hold directors personally liable. See H.R. Rep. No. 222, 101st Cong., 1st Sess., 393, 398 (1989), *reprinted in* 1989 U.S.C.A.N. 432, 437 ("[FIRREA] preempts State law with respect to claims brought by the FDIC in any capacity against officers or directors of an insured depository institution."); 135 CONG. REC. S6912 (daily ed. June 19, 1989) ("[Section 1821(k) of FIRREA] enables the FDIC to pursue claims against directors or officers of insured financial

section 1821(k).³³

A. Section 1821(k)

Section 1821(k) contains two relevant parts that determine the propriety of state law claims under FIRREA.³⁴ The first sentence of section 1821(k) states that, in actions brought by federal regulatory agencies, directors of federally insured financial institutions “may” be liable “for gross negligence, including any similar conduct that demonstrates a greater disregard of a duty of care”³⁵ Thus, by authorizing federal regulators to sue for gross negligence, Congress preempted state laws that predicated director liability upon reckless or other more culpable misconduct, as well as those statutes that permitted shareholders to eliminate a director’s liability.³⁶ However, Congress expressly left the task of defining gross negligence to the states.³⁷

institutions for gross negligence (or negligent conduct that demonstrates a greater disregard of a duty of care than gross negligence) or for intentional tortious conduct. This right supersedes state law limitations that . . . would bar or impede such claims.”).

33. See 135 CONG. REC. S4278 (daily ed. April 19, 1989). Senator Reigle’s discussion of the provision that would ultimately evolve into § 1821(k) explained that state insulating statutes protected directors from liability and that:

[§ 1821(k)] totally preempt[s] State law in this area with respect to suits brought by the FDIC against bank directors or officers. However, in light of the State law implications raised by this provision, . . . State law would be overruled only to the extent that it forbids the FDIC to bring suit based on “gross negligence” or an “intentional tort.” In determining whether or not conduct constitutes “gross negligence” or an “intentional tort,” applicable State law is to govern. *This amendment would thus allow the FDIC to sue a director or officer guilty of gross negligence or willfull misconduct, even if State law did not allow it.*

Id. (emphasis added).

34. 12 U.S.C. § 1821(k) provides in pertinent part:

A director or officer of an insured depository institution may be held personally liable for monetary damages in any civil action by, on behalf of, or at the request or direction of the [FDIC or RTC] . . . for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct as such terms are defined and determined under applicable State law. Nothing in this paragraph shall impair or affect any right of the [FDIC or RTC] under other applicable law.

§ 12 U.S.C. § 1821(k) (Supp. V 1993).

35. *Id.*

36. See *supra* notes 31-32. Under the Supremacy Clause of the United States Constitution state laws that conflict with a provision of federal law will be preempted. See generally *Wisconsin Public Intervenor v. Mortier*, 501 U.S. 597, 604-06 (1991) (ruling a local government’s attempt to regulate pesticide use was preempted by the Federal Insecticide, Fungicide and Rodenticide Act). Thus, any state law requiring conduct more culpable than gross negligence to impose liability would be preempted under FIRREA’s authorization of suits for gross negligence. See 12 U.S.C. § 1821(k) (Supp. V 1993).

37. *Id.* Definitions of gross negligence vary from state to state. See W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 34, at 212 (5th ed. 1984) (“There is . . . no generally

The second sentence of section 1821(k) impacts the validity of state law simple negligence claims under FIRREA, by preserving federal regulators' rights to sue directors under "other applicable law."³⁸ This phrase clearly demonstrates Congress' intent not to impair federal regulators' access to other, more stringent means of exposing directors to liability.³⁹

Surprisingly, despite the fact that over half of all savings and loans have federal charters,⁴⁰ neither FIRREA's text nor its history refer to those charters.⁴¹ The statute's failure to differentiate between state and federally chartered institutions permits the conclusion that section 1821(k) and its preservation of state law claims applies to both types of institutions. Moreover, in light of Congress' goal of empowering federal regulators,⁴² congressional silence on the matter strongly suggests that it did not intend to use FIRREA's gross negligence standard to insulate directors from liability when they would otherwise be subject to state law simple negligence standards.⁴³ Nonetheless, there is some doubt as to whether directors of federally chartered institutions remain subject to state law simple negligence claims.

B. Cases Interpreting Section 1821(k)

Two types of cases shed light on the propriety of state law simple negligence claims against the directors of federally chartered institutions. First, both the Ninth and Tenth Circuits have recently discussed the validity

accepted meaning [of gross negligence].").

38. 12 U.S.C. § 1821(k) (Supp. V 1993).

39. See *supra* note 33; see also 135 CONG. REC. S 6912 (daily ed. June 19, 1989) ("[Section 1821(k)] does not prevent the FDIC from pursuing claims under State law or under other applicable Federal law, if such law permits the officers or directors of a financial institution to be sued . . . for violating a lower standard of care, such as simple negligence.") For a thorough discussion of FIRREA's legislative history and support of FIRREA's preservation of state law claims against state chartered institutions, see Shepard, *supra* note 3. For a discussion of the possible use of FIRREA as a defense to state law claims, see Fischer, *supra* note 22.

40. See National Comm'n on Financial Institution Reform, Recovery and Enforcement: Origins and Causes of the S&L Debacle: A Blueprint for Reform: A Report to the President and Congress (G.P.O. 1993).

41. See FIRREA, Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified in scattered sections of the U.S.C.); see also *Resolution Trust Corp. v. Chapman*, 29 F.3d 1120, 1126 (7th Cir. 1994) (Posner, J., dissenting) ("The liability of directors of S&L's which happened to have federal rather than state charters was not discussed [by Congress], even though more than half of all S&L's were federally chartered.").

42. See *supra* note 30 and accompanying text.

43. For a discussion of FIRREA's legislative history indicating that directors may be subject to suits under state law standards of liability after FIRREA, see *supra* note 39 and accompanying text.

of state law claims against state chartered institutions. These cases illustrate how section 1821(k) operates to effectuate Congress' purpose of subjecting directors to liability for their negligent actions.⁴⁴ Second, in *Resolution Trust Corp. v. Gallagher*,⁴⁵ the Seventh Circuit recently discussed FIRREA's effect on federal common law claims against federal institutions. *Gallagher* provides a framework for analyzing FIRREA in the federal charter context.⁴⁶

1. State Law and the State-Chartered Institution

In *Federal Deposit Insurance Corp. v. Canfield*,⁴⁷ the Tenth Circuit held that FIRREA does not hinder the ability of federal regulators to rely on state law simple negligence claims against state chartered institutions.⁴⁸ In *Canfield*, the Federal Deposit Insurance Corporation (FDIC) brought a state law claim against the directors of a Utah Savings and Loan for negligent mismanagement of the institution.⁴⁹ Arguing that section 1821(k) preempts state law simple negligence liability by imposing a federal gross negligence standard, the directors of the institution sought to dismiss the FDIC's simple negligence claim.⁵⁰

However, the Tenth Circuit explained that the language, purpose, and history of FIRREA did not support the directors' position.⁵¹ In rejecting the directors' argument, the *Canfield* court focused first on the plain

44. See *infra* notes 47-65.

45. 10 F.3d 416 (7th Cir. 1993).

46. See *infra* notes 66-77.

47. 967 F.2d 443 (10th Cir.), cert. dismissed, 113 S. Ct. 516 (1992).

48. *Id.* at 449. A number of district courts have held similarly. See, e.g., *RTC v. Rahn*, 854 F. Supp. 480 (W.D. Mich. 1994); *RTC v. Heiserman*, 839 F. Supp. 1457 (D. Colo. 1993); *RTC v. DiDomenico*, 837 F. Supp. 623 (D.N.J. 1993); *RTC v. Gershman*, 829 F. Supp. 1095 (E.D. Mo. 1993); *FDIC v. Miller*, 781 F. Supp. 1271 (N.D. Ill. 1991); *FDIC v. Williams*, 779 F. Supp. 63 (N.D. Tex. 1991), claim dismissed, 781 F. Supp. 1271. But see *FDIC v. Swager*, 773 F. Supp. 1244 (D. Minn. 1991); *FDIC v. Brown*, 737 F. Supp. 626 (D. Utah 1989).

49. *Canfield*, 967 F.2d at 444.

50. *Id.* at 445.

51. *Id.* at 446-449. In stating its holding, the court noted that "the plain language of the statute demands" a denial of the defendants' motion to dismiss. *Id.* at 449. In addition to basing its decision on the text of § 1821(k), the court also indicated that FIRREA's "legislative history is consistent with our interpretation of the statute's plain language." *Id.* at 448 n.6 (citing 135 CONG. REC. S4278-79 (daily ed. April 19, 1989); 135 CONG. REC. S6912 (daily ed. June 19, 1989)). Also, the court noted that to hold that federal regulators could not bring state law claims would frustrate Congress's stated purpose of protecting the federally insured deposit funds. *Id.* at 449 (citing FIRREA, Pub. L. No. 101-73, § 101(3), 103 Stat. 183, 187 (1989) (codified at 12 U.S.C. § 1811 (note) (Purpose of 1989 Amendment) (Supp. V 1993))).

language of section 1821(k).⁵² The court held that because section 1821(k) states that federal regulators “may” bring actions for gross negligence, as opposed to “may only” bring an action for gross negligence, FIRREA did not foreclose a state law simple negligence action.⁵³

The court found support for its conclusion in section 1812(k)’s section dealing with preservation of “other applicable law.”⁵⁴ Believing state law simple negligence claims to constitute “other applicable law,” the court reasoned that Congress authorized simple negligence claims when the state in which the institution operated permitted such claims.⁵⁵ The court also noted that Congress’ decision to let the state law define gross negligence belied the directors’ argument that Congress intended FIRREA to set a uniform gross negligence standard.⁵⁶

Finally, the court noted an absurdity in the directors’ position.⁵⁷ The court explained that the failure of a financial institution triggers the federal regulators’ ability to sue the institution’s directors on behalf of the

52. *Canfield*, 967 F.2d at 449 (“We hold that the plain language of the statute demands” application of the state law standard of care.). In particular, the court focused on the language in § 1821(k) providing that “a director or officer *may* be held personally liable for monetary damages . . . for gross negligence.” *Id.* at 446 (alteration in original) (citing 12 U.S.C. § 1821(k) (Supp. V 1993)).

53. *Id.* The court stated that:

“May” is a permissive term, and it does not imply a limitation on the standards of officer and director liability. . . . [N]o reasonable construction of “may” results in an absolute limitation of the liability of officers or directors to instances of gross negligence. Rather, the first sentence of section 1821(k) effectively provides that even where state law under which the FDIC is authorized to bring suit otherwise limits actions against officers and directors to intentional misconduct, an officer or director may nevertheless be held liable for gross negligence. In states where an officer or director is liable for simple negligence, however, the FDIC may rely, as it does in this case, on state law to enable its action.

Id. (citations omitted). For additional case law supporting the position that “may” does not equate to “may only,” see *Rose v. Rose*, 481 U.S. 619, 626-27 (implying that “may” should not be read as “may only”), and *Resolution Trust Corp. v. Lightfoot*, 938 F.2d 65, 66-67 (7th Cir. 1991) (same).

54. *Canfield*, 967 F.2d at 446-47. For a statement of the pertinent provision of § 1821(k), see *supra* note 34.

55. *Canfield*, 967 F.2d at 446-47. The court explained its reasoning with regard to § 1821(k)’s last sentence as follows:

[W]e believe that “other applicable law” means *all* “other applicable law.” Under the statute then, any other law providing that an officer or director may be held liable for simple negligence survives; such a law would be an “other applicable law,” and construing the statute to bar its application would “impair the FDIC’s rights under it.”

Id. (footnote omitted).

56. *Id.* at 447. The court reasoned that “[s]tate law definitions of gross negligence differ. Indeed, ‘there is . . . no generally accepted meaning [of gross negligence].’ These differences mean that the statute cannot possibly, even without the last sentence, create a national standard of liability.” *Id.* (citations omitted).

57. *Id.* at 449.

shareholders, whereas a shareholder of the institution can sue under state law at any time prior to failure.⁵⁸ Thus, the court noted that preventing federal regulators from employing state law provisions could, in effect, induce directors of a struggling institution to allow the institution to fail in order to obtain the shield of FIRREA's gross negligence standard.⁵⁹ Reasoning that such a result would impair Congress' purpose of protecting federally insured deposit funds, the court held that FIRREA did not preempt state law provisions for simple negligence applied to state chartered institutions.⁶⁰

Three months after *Canfield*, the Ninth Circuit reached the same conclusion in *Federal Deposit Insurance Corp. v. McSweeney*.⁶¹ *McSweeney* involved the FDIC's attempt to hold the directors of a California savings and loan liable under that state's simple negligence standard of liability.⁶² The directors moved to dismiss the state law claim, also arguing that FIRREA set a uniform gross negligence standard of liability and therefore preempted actions based on state law.⁶³ Relying on reasoning similar to the *Canfield* court's,⁶⁴ the Ninth Circuit rejected the directors' motion to dismiss and held that FIRREA permits federal

58. *Id.*

59. *Canfield*, 967 F.2d at 449.

60. *Id.* ("It simply cannot be that FIRREA would indirectly encourage such behavior . . .").

61. 976 F.2d 532 (9th Cir. 1992), *cert. denied*, 113 S. Ct. 2440 (1993).

62. *Id.* at 533. When appointed to the board of Central Savings and Loan, McSweeney instituted some questionable loan and investment programs which resulted in substantial losses. *Id.* The Federal Savings and Loan Insurance Company (FSLIC) placed Central into receivership. *Id.* Because of the receivership, the FDIC succeeded to Central's claims against McSweeney and subsequently brought suit under California Corporate Code § 309 for negligent mismanagement of the institution. *Id.* at 533-34.

63. *Id.* at 534. The directors also argued that the FDIC's claim was barred by the statute of limitations. *Id.* The court disagreed. *Id.* at 536.

64. *Id.* at 536-41. In many ways, the *McSweeney* court's opinion parallels that of the Tenth Circuit in *Canfield*. The *McSweeney* court began its analysis by focusing on the permissive nature of § 1821(k)'s first sentence. *Id.* at 537-38 ("Had Congress intended this authorizing provision to limit the FDIC to claims alleging gross negligence or greater culpability, it would have inserted the word 'only' in the sentence."). The court also relied upon the second sentence of § 1821(k) to reject the defendants' argument that FIRREA created a single, uniform standard. *Id.* at 538-39. ("Like the *Canfield* court, we find no limitation [in the second sentence of § 1821(k)] that would preclude the FDIC from seeking remedies available under state law."). Moreover, the *McSweeney* court noted that its reading of the statute's plain language squared with the statute's legislative history. *Id.* at 540. Finally, similar to the *Canfield* court, the *McSweeney* court thought that the directors' argument that FIRREA created a uniform standard of gross negligence would create "the perverse incentive for a director in an institution that is having financial difficulty to permit the thrift to fall into ruin . . . since the director's own exposure would be greatly reduced upon the institution of a receivership." *Id.* (quoting *Federal Deposit Insurance Corp. v. McSweeney*, 772 F. Supp. 1154, 1159 (S.D. Cal. 1991), *aff'd*, 976 F.2d 532 (9th Cir. 1992), *cert. denied*, 113 S. Ct. 2440 (1993)).

regulators to sue directors of failed financial institutions under a more stringent standard of liability than gross negligence if state law allows such a claim.⁶⁵

2. Federal Common Law Actions after FIRREA

Another type of case interpreting section 1821(k) involves federally chartered institutions. These cases address whether FIRREA's gross negligence standard preempts federal common law's simple negligence standard.⁶⁶ In 1993, the Seventh Circuit became the first circuit to analyze the propriety of a federal common law simple negligence action after FIRREA.⁶⁷

In *Resolution Trust Corp. v. Gallagher*,⁶⁸ the Resolution Trust Corporation (RTC) sued the directors of a federally chartered institution.⁶⁹ The RTC sought to recover losses resulting from the directors' negligence.⁷⁰ The RTC premised its claim on the theory that FIRREA did not preempt federal common law actions based on simple negligence.⁷¹

65. *McSweeney*, 976 F.2d at 541.

66. In all cases discussing this issue, courts have accepted for the sake of argument that federal common law provides for simple negligence liability. The majority of these courts have ruled that FIRREA's gross negligence standard preempts federal common law. *See, e.g.*, *RTC v. Miramon*, 22 F.3d 1357, 1364 (5th Cir. 1994); *FDIC v. Harrington*, 844 F. Supp. 300, 304-05 (N.D. Tex. 1994); *FDIC v. Bates*, 838 F. Supp. 1216, 1220 (N.D. Ohio 1993), *rev'd*, 42 F.3d 369 (6th Cir. 1994); *FDIC v. Gonzalez-Gorron dona*, 833 F. Supp. 1545, 1552 (S.D. Fla. 1993); *RTC v. Farmer*, 823 F. Supp. 302, 307 (E.D. Pa. 1993); *RTC v. Hecht*, 818 F. Supp. 894, 901-02 (D. Md. 1992); *FDIC v. Brown*, 812 F. Supp. 722, 726 (S.D. Tex. 1992); *FDIC v. Barham*, 794 F. Supp. 187, 191 (W.D. La. 1991), *aff'd*, 995 F.2d 600 (5th Cir. 1993); *FDIC v. Miller*, 781 F. Supp. 1271, 1275 (N.D. Ill. 1991). *See contra* *RTC v. Gibson*, 829 F. Supp. 1110, 1118 (W.D. Mo. 1993); *RTC v. Hess*, 820 F. Supp. 1359, 1364 (D. Utah 1993) (concluding that "§ 1821(k) does not . . . preempt applicable . . . federal common law."); *FDIC v. Nihiser*, 799 F. Supp. 904, 907 (C.D. Ill. 1992).

67. *RTC v. Gallagher*, 10 F.3d 416, 417 (7th Cir. 1993) ("No other circuit courts have directly addressed this issue.").

68. 10 F.3d 416 (7th Cir. 1993).

69. *Id.* at 418. In 1990, the Concordia Federal Bank for Savings failed and the RTC placed the institution into receivership. *Id.* The RTC instituted the federal common law simple negligence actions on behalf of the shareholders of the institution against Concordia's directors. The directors allegedly had mismanaged the bank, causing it to incur losses and fail. *Id.*

70. *Id.* In addition to negligence, the RTC also alleged breach of fiduciary duty, gross negligence and breach of contract. *Id.*

71. *Id.* The RTC's argument that FIRREA did not preempt federal common law relied primarily on the framework developed by the *Canfield* and *McSweeney* courts for state law claims. *Id.* at 420-22. The RTC argued that the permissive language of § 1821(k)'s first sentence, the savings clause in the second sentence, and Congress' purpose of strengthening the power of federal regulators equally supported the preservation of federal common law simple negligence claims and state law simple negligence claims. *Id.*

The Seventh Circuit sustained the directors' motion to dismiss the RTC's federal common law simple negligence claim, holding that FIRREA preempted federal common law.⁷² The court stated that, in order to preempt federal common law, Congress need only speak directly to the issue at hand.⁷³ The court found that FIRREA's authorization of gross negligence actions spoke directly to the standard of care issue and therefore preempted any preexisting federal common law standard.⁷⁴ The court refused to read FIRREA's savings clause as preserving federal common law simple negligence actions because such a reading would make 1821(k)'s authorization of gross negligence actions mere surplusage.⁷⁵

However, the *Gallagher* court declined to decide whether FIRREA preempted state law simple negligence claims against directors of a federally chartered institution.⁷⁶ According to the court, when federal preemption of state law is at issue, concerns of federalism require greater evidence of Congress' preemptory intent than a consideration of the propriety of federal common law after congressional action.⁷⁷ The court's

72. *Gallagher*, 10 F.3d at 424-25.

73. *Id.* at 419. The court noted at the outset that federal common law plays a very limited role in areas where Congress has legislated. *Id.* The court recognized that Congress, not the federal courts, determines the appropriate standards for federal law. *Id.* Thus, the court reasoned, if Congress "spoke directly" to the issue of what standard of liability governs suits brought by the RTC against officers and directors of failed federally chartered financial institutions, "then the federal common law standards would be preempted. *Id.*

74. *Id.* at 424-25. In answering whether Congress spoke directly to the issue at hand, the court noted the following:

It is hard to imagine a more definitive statement by Congress that a gross negligence standard of liability applies to cases brought by the RTC against officers and directors of failed financial institutions. Consequently, federal common law . . . must yield to Congress' clear statement that a gross negligence standard of liability applies.

Id. at 420. To support its conclusion, the court referred to prior United States Supreme Court precedent that found federal common law standards for interstate water pollution to be preempted by Congress' creation of "a comprehensive regulatory program supervised by an expert administrative agency." *Id.* at 423-24 (quoting *Milwaukee v. Illinois*, 451 U.S. 304, 317 (1981)). The *Gallagher* court noted that similar to the legislation at issue in *Milwaukee*, FIRREA created a complex regulatory regime that left no room for federal common law. *Id.* at 424.

75. *Id.* at 420 ("It is illogical that Congress intended in one sentence to establish a gross negligence standard of liability and in the next sentence to eviscerate that standard by allowing actions under federal common law for simple negligence.").

76. *Id.* at 424 ("[W]e stress that we do not reach the issue of whether § 1821(k)'s gross negligence standard pre-empts state law.").

77. *Id.* In explaining the differing standards governing preemption of state law as opposed to federal common law, the court stated that:

[T]he appropriate analysis in determining if federal statutory law governs a question previously the subject of federal common law is not the same as that employed in deciding if federal law pre-empts state law. In considering the latter question "we start with the

refusal to rule on the preemption of state law in the federal charter context left the issue open for future consideration. Moreover, by noting the greater standard of proof required when state law claims are involved, the court invited federal regulators to bring state law simple negligence claims against directors of federal institutions. In 1994, the RTC accepted the invitation.

III. *RESOLUTION TRUST CORP. v. CHAPMAN*: A UNIFORM STANDARD OF LIABILITY FOR DIRECTORS OF FEDERALLY CHARTERED FINANCIAL INSTITUTIONS

In *Resolution Trust Corp. v. Chapman*, the Seventh Circuit became the first circuit to analyze FIRREA in a case involving state law claims against directors of a federally chartered institution.⁷⁸ The decision departed from the cases that recognize Congress' preservation of state law claims for simple negligence.⁷⁹ In turn, the court signaled the development of a uniform gross negligence standard of liability for directors of insolvent, federally chartered financial institutions.⁸⁰

In *Chapman*, the RTC sued the former directors of a failed, federally

assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." While we have not hesitated to find pre-emption of state law, whether express or implied, when Congress has so indicated, or when enforcement of state regulations would impair "federal superintendence of the field," our analysis has included "due regard for the presuppositions of our embracing federal system, including the principle of diffusion of power not as a matter of doctrinaire localism but as a promoter of democracy." Such concerns are not implicated in the same fashion when the question is whether federal statutory or federal common law governs, and accordingly, the same sort of evidence of clear and manifest purpose is not required.

Id. (quoting *Milwaukee*, 451 U.S. at 316-17).

78. 29 F.3d 1120 (7th Cir. 1994). Prior to the *Chapman* decision, three district court cases briefly touched upon the propriety of state law claims against directors of federal institutions. See *RTC v. Ascher*, No. CIV.A.92-B-424, 1994 WL 52687, at * 3 (D. Colo. Feb. 14, 1994) (concluding that FIRREA's savings clause "allows the RTC to bring state based claims for ordinary negligence against the director defendants of a federally insured, federally-chartered institution."); *RTC v. Farmer*, 823 F. Supp. 302, 307 (E.D. Pa. 1993) (concluding that state law claims cannot be brought against directors of federally chartered institutions); *RTC v. Hess*, 820 F. Supp. 1359, 1362 (D. Utah 1993) ("[F]ederal law exclusively governs the internal affairs of federal savings and loan associations, including director liability.").

79. For a discussion of the two main cases preserving state law claims, see *supra* notes 47-65 and accompanying text. While these cases involved state chartered institutions, one district court, without mentioning *McSweeney*, noted that *Canfield* "did not rest upon whether the institution held a state or federal charter." *Ascher*, 1994 WL 52687 at *3.

80. *Chapman*, 29 F.3d at 1123 (stating that FIRREA "adopts gross negligence as the rule for managers and directors of federal financial institutions").

chartered financial institution that operated in Illinois.⁸¹ The RTC, on behalf of the institution's shareholders, sought to recover damages allegedly resulting from injuries to the federal deposit insurance fund and to the institution's financial standing.⁸² Consistent with Illinois law,⁸³ the RTC based its claim on a simple negligence theory.⁸⁴

The majority held that a gross negligence standard governs suits by the RTC against directors of failed federally chartered financial institutions.⁸⁵ The majority opinion endorsed the *Canfield* and *McSweeney* decisions,⁸⁶ acknowledging that the savings clause in FIRREA permits state law claims based on conduct less culpable than the gross negligence standard prescribed by FIRREA.⁸⁷ Having determined that FIRREA does not preempt state law simple negligence claims against directors of state chartered institutions, the court then examined whether federal regulators may take advantage of state law in actions against federally chartered financial institutions.⁸⁸ The court concluded that a choice of law principle known as the "internal affairs doctrine" prevents the application of state simple negligence standards to federally chartered institutions.⁸⁹ By creating a rebuttable presumption in favor of the incorporating jurisdiction's standard of liability, the internal affairs doctrine resolves the potentially conflicting

81. Chapman, 29 F.3d at 1121-22.

82. *Id.* at 1121.

83. *Id.* at 1122. The court assumed that Illinois common law permitted recovery against negligent directors of financial institutions. *Id.* (citing *Chicago Title & Trust Co. v. Munday*, 131 N.E. 103 (Ill. 1921)).

84. Chapman, 29 F.3d at 1122.

85. *Id.* at 1123.

86. See *supra* notes 41-60 and accompanying text.

87. *Id.* Chapman, 29 F.3d at 1122. The directors responded to the RTC's simple negligence claim by arguing that FIRREA preempted all state law claims. After studying the language of § 1821(k), the court found the directors' position untenable. *Id.* The court noted that:

The final sentence of § 1821(k) . . . ensures that actions based on state law are not preempted. Even if we doubted the correctness of [*McSweeney* and *Canfield*] which we do not, we would not think it prudent to create a conflict among the circuits. Clauses similar to the final sentence of § 1821(k) regularly are understood to save state law against claims of preemption. Thus, the RTC may take advantage of any claims available to it under state law.

Id. at 1122 (citations omitted).

88. *Id.*

89. *Id.* at 1123. Regarding the appropriate standard of liability to apply, the court determined that "[t]he advent of inter-state banking . . . leads us to apply the internal affairs doctrine to this case. Security held a federal charter, so national law governs the liability of officers and directors for their management." *Id.* For additional discussion of the rationale behind the internal affairs doctrine, see *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 88-93 (1987); *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982).

obligations that follows a corporation's multistate operations.⁹⁰ Courts applying the internal affairs doctrine have permitted parties to rebut this presumption if the "justified expectations" of those connected with the corporation warrant application of the forum state's laws.⁹¹ Similarly, if the law of the jurisdiction of incorporation is difficult to determine, considerations of "certainty"⁹² and "ease in determination"⁹³ may warrant application of the forum state's laws.⁹⁴ While the *Chapman* court acknowledged that the internal affairs doctrine is merely a rebuttable presumption,⁹⁵ it applied the doctrine as a bright line rule, failing to consider the factors that traditionally have been applied to rebut the presumption in favor of the incorporating jurisdiction's standard.⁹⁶

The *Chapman* court's application of the internal affairs doctrine led it to conclude that, regardless of FIRREA's preservation of state law claims, federal law governs directors of insolvent federal institutions.⁹⁷ In searching for the appropriate standard under federal law, the court followed the *Gallagher* court's holding⁹⁸ that section 1821(k)'s gross negligence standard, rather than any more stringent federal common law, controlled.⁹⁹

90. The *Chapman* court explained the internal affairs doctrine and its application to issues of liability standards as follows:

When the subject is liability of officers and directors for their stewardship of the corporation, the law presumptively applicable is the law of the place of incorporation. This venerable choice-of-law principle, known as the internal affairs doctrine, is recognized throughout the states, and by the Supreme Court as well.

29 F.3d at 1122 (citations omitted); see generally RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 309 (1971).

91. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 6, 309 (1971) (providing that the internal affairs doctrine's presumption in favor of the incorporating jurisdiction's laws may be rebutted by reference to the "justified expectations" of those connected with the corporation).

92. *Id.*

93. *Id.*

94. Several courts have applied such factors to rebut the presumption in favor of the incorporating jurisdiction's laws. See, e.g., *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 263-64 (2d Cir. 1984); *Mansfield Hardwood Lumber Co. v. Johnson*, 268 F.2d 317, 320-21 (5th Cir. 1959); *Ficor, Inc. v. McHugh*, 639 P.2d 385, 391 (Colo. 1982) (en banc).

95. *Chapman*, 29 F.3d at 1122.

96. See *id.* at 1123. After discussing why the internal affairs doctrine should apply to a federally chartered institution doing business in a state, the court simply noted that "[s]ecurity held a federal charter, so national law governs the liability of officers and directors for their management." *Id.*

97. *Id.*

98. Two of the three judges deciding *Chapman* wrote separate opinions expressing their dissatisfaction with the *Gallagher* decision, but also noting its precedential weight. *Id.* at 1125 (Rouner, J., concurring), 1125-28 (Posner, C.J., dissenting).

99. *Id.* at 1123. In concluding its search for the relevant federal law to apply, the court noted "[w]e concluded in *Gallagher* that [§ 1821(k)] adopts gross negligence as the rule for managers and directors

Accordingly, because the internal affairs doctrine required application of the gross negligence standard enunciated in FIRREA, the court dismissed the RTC's state law simple negligence claim.¹⁰⁰

Judge Posner dissented from the majority's opinion.¹⁰¹ He argued that Congress' failure to mention the charter of an institution in FIRREA did not warrant the court's creation of a new immunity for directors of federal institutions who would have otherwise been subjected to the negligence standard of a particular state.¹⁰² Judge Posner recognized that Congress designed FIRREA to make directors of failed financial institutions more susceptible to liability and concluded that the majority opinion diluted the power of federal regulators in contravention to this purpose.¹⁰³

Judge Posner also concluded that the court misapplied the internal affairs doctrine.¹⁰⁴ To support his claim, Posner focused on "justified expecta-

of federal financial institutions. We need not devise federal common law; Congress has laid down the law." *Id.*

100. *Chapman*, 29 F.3d at 1124-25.

101. *Id.* at 1125-28. In addition to Judge Posner's dissent, Judge Rovner wrote a concurring opinion. *Id.* at 1125. In her opinion, Judge Rovner expressed sympathy for Judge Posner's analysis but agreed with Judge Easterbrook that the internal affairs doctrine "compels application of federal law to the internal affairs of a federally-chartered institution." *Id.*

102. *Id.* at 1126. Judge Posner examined the text of FIRREA and noted that Congress did not even mention the effect a federal charter may have on director liability. *Id.* Rather than imply from the congressional silence that federal regulators could only sue directors of federal institutions for gross negligence, Judge Posner focused on Congress' intent in passing FIRREA and sought to explain FIRREA's silence. *Id.* Judge Posner suggested that:

[t]he likeliest reason for the apparent oversight is that there was no history of having to decide which jurisdiction's law would govern a particular dispute over directors' liability. Directors' liability had been primarily a common law field; the pertinent common law doctrines (the business-judgement rule, the duty of loyalty, etc.) had been similar across states and similar also to the federal common law of directors' liability . . . ; and banks and related financial institutions were invariably local rather than multistate, so potential interstate conflicts in the obligations of bank directors could not arise. Congress is not gifted with omniscience and does not have the leisure to be able to tie a pretty ribbon around every piece of legislation, and so it often either overlooks or chooses not to attempt to solve problems that lack present salience or urgency. The use by judges of the form of words that Congress has employed to deal with . . . the problem of states' curtailing the liabilities of directors . . . to solve a problem of which there is no evidence that Congress was even aware is a formula for the perversion of legislative purpose. We play "Gotcha!" with Congress. We make traps of its words.

Id.

103. *Id.* at 1127. In discussing the effect of the majority's opinion, Judge Posner noted that "[w]hat would otherwise be a more stringent standard, that of simple negligence, is diluted by interpretation of a statute intended to make the liability of such directors more stringent. The statute has been turned on its head." *Id.*

104. *Chapman*, 29 F.3d at 1126 ("Even if we indulge the fiction that Congress was secretly aware of the internal-affairs doctrine of corporation law and secretly intended it to apply to suits by the RTC against federally chartered S & Ls, it does not follow, as the court believes, that the doctrine would bar

tions,” noting that all evidence indicated that those connected with the institution thought Illinois law would apply to a dispute of this character.¹⁰⁵ Moreover, with regard to the “certainty” considerations that may also rebut the presumption in favor of the incorporating jurisdiction’s standards, Posner highlighted the confusion surrounding whether FIRREA’s gross negligence standard or a standard existing under federal common law constituted the appropriate federal law standard.¹⁰⁶ According to the dissent, this confusion justified application of Illinois’ more certain simple negligence provisions.¹⁰⁷

Simply stated, the *Chapman* holding provides that, regardless of any state law provisions for simple negligence culpability, directors of failed, federally chartered institutions may only be sued for gross negligence¹⁰⁸ or conduct evincing a greater disregard of their duty of care.¹⁰⁹ By rendering an act of Congress subordinate to the internal affairs doctrine and, in effect, using FIRREA to insulate rather than expose directors of financial institutions, the *Chapman* decision marks a disturbing departure from congressional intent.

the application of Illinois law in this case.”). For a case decided after the *Chapman* decision that supports Posner’s application of the internal affairs doctrine see *RTC v. Everhart*, 37 F.3d 151 (4th Cir. 1994).

105. 29 F.3d at 1126-27. Judge Posner began his internal affairs analysis by stressing that the doctrine only creates a rebuttable presumption in favor of application of the law of the incorporating jurisdiction. *Id.* He noted that this presumption may be overcome by demonstrating that the “justified expectations” of those connected with the business warrant application of another jurisdiction’s laws. *Id.* at 1127. Considering the expectations of those involved in the instant case, Judge Posner noted that:

[e]veryone connected with Security would have thought Illinois law applicable to a dispute of this character. Security had been an Illinois corporation for a century, and nothing in the text or provision of the statute under which it converted to a federal S & L would have suggested that the liability of its directors or officers was being altered by the change.

Id.

106. *Id.* (“This case well illustrates the difficulty of determining the rule of decision if federal law, the law of the chartering jurisdiction, is applied instead of the law of the S & L’s principal place of business.”). *Id.*

107. *Id.* Because of the possibility that federal common law standards rather than the standard established in FIRREA constituted the appropriate federal standard, Judge Posner found the federal standard to be fraught with uncertainty. However, he noted, “[t]here is no comparable uncertainty about the contents of the Illinois law of director’s liabilities.” *Id.* Based on the relative certainty of the proper standard under federal and state law, Posner concluded that state law provided the more certain, and therefore the more proper, standard of liability. *Id.*

108. See *supra* text accompanying note 85.

109. See 12 U.S.C. § 1821(k) (Supp. V 1993).

VI. CHAPMAN'S IMPACT

The *Chapman* court's decision to limit federal regulators' efforts to hold directors of failed federally chartered financial institution liable for their actions will affect several aspects of financial institution regulation.

A. Frustrating Intent: Insulating Directors

Congress enacted FIRREA to make it easier for injured parties to sue directors of failed financial institutions.¹¹⁰ Prior to *Chapman*, a state could, consistent with FIRREA's purpose, raise the standard of care for directors to afford its citizens the added protection of a simple negligence standard.¹¹¹ The *Chapman* holding creates a uniform standard of liability for directors of federally chartered institutions and removes a state's power to impose higher standards of care on directors of such institutions.¹¹² This decision frustrates Congress' purpose of empowering federal regulators by making it harder to sue directors of institutions in simple negligence states.¹¹³ Moreover, it contradicts the language of section 1821(k) that gives states the authority to enact "other applicable law" that federal regulators may utilize.¹¹⁴

In addition to transforming FIRREA into a statute that weakens the powers of federal regulators, the *Chapman* holding also places federally insured deposit funds at risk by creating an incentive for directors to let a federally chartered institution slip into insolvency.¹¹⁵ As noted by both

110. See *supra* notes 30-33 and accompanying text.

111. See *Chapman*, 29 F.3d at 1126 (Posner, J., dissenting) (criticizing the majority opinion for "creating a new immunity for directors of federal S & Ls by depriving the RTC of the benefit of state laws that imposed higher duties on directors.").

112. See *id.* at 1125 (Posner, J., dissenting) (noting that after *Chapman* "the RTC must prove gross negligence, even though Illinois law makes the directors of financial institutions to which its law applies liable to shareholders for simple negligence.").

113. See *supra* note 30 and accompanying text.

114. See 12 U.S.C. § 1821(k) (Supp. V 1993) ("Nothing in this paragraph shall impair or affect any right of the [federal regulatory agencies] under other applicable law."). For a discussion of the cases that have interpreted this section to preserve state law simple negligence actions see *supra* notes 54-56, 66-67 and accompanying text. See also *Chapman*, 29 F.3d at 1122 (endorsing the opinions of courts that have held FIRREA not to preempt causes of actions based on state law).

115. Without relying on the charter of the institution, a few state charter cases have recognized that denying federal regulators access to state law simple negligence claims makes it harder to hold directors responsible when the institution fails. See, e.g., *FDIC v. McSweeney*, 976 F.2d 532, 540-41 (9th cir. 1992); *FDIC v. Canfield*, 967 F.2d 443, 449 (10th Cir. 1992). Clearly this effect contravenes Congress' intent to curtail activities that placed the federally insured deposit funds at risk. See *supra* note 31 and accompanying text.

the Ninth and Tenth Circuits,¹¹⁶ under FIRREA, a federal regulator's right to sue the directors of an institution commences upon the institution's declaration of insolvency and subsequent entry into receivership.¹¹⁷ Because the shareholders of an institution doing business in a simple negligence state may bring actions for simple negligence prior to insolvency,¹¹⁸ the *Chapman* court's decision to limit federal regulators to bringing actions for gross negligence gives directors of federally chartered institutions the incentive to allow their institutions to become insolvent.¹¹⁹ The creation of this perverse incentive frustrates FIRREA's goal of curtailing activities that threaten the federally insured deposit fund.¹²⁰

B. High Cost for Uniformity: Impairing a State's Regulatory Powers Under FIRREA

The propriety of *Chapman*'s holding after *Canfield* and *McSweeney* depends in part on the effect that a federal charter has on the analysis under FIRREA and the validity of state law claims.¹²¹ By authorizing federal charters, Congress sought to establish a regulatory regime that would promote uniformity in banking.¹²² Congress vested the Office of Thrift Supervision (OTS) with authority to regulate all aspects of federal financial institutions.¹²³ To date, the OTS has not promulgated any regulations governing the standard of care owed by directors of federally chartered

116. See *supra* notes 47-65 and accompanying text.

117. See 12 U.S.C. § 1821(d)(2)(A) (Supp. V 1993). Section 1821(d)(2)(A) provides that the federal regulatory agencies "shall, as conservator or receiver, and by operation of law, succeed to . . . all rights, titles, powers, and privileges of the insured depository institution, and of any stockholder, member, accountholder, depositor, officer, or director of such institution . . ." *Id.*

118. See *McSweeney*, 976 F.2d at 540 ("Before the failure of a thrift and the involvement of federal regulators, liability would attach for simple negligence.").

119. See *Chapman*, 29 F.3d at 1123-25. The court held that federal regulators could only sue directors for gross negligence. *Id.* By denying federal regulators the right to sue for simple negligence, the court precludes simple negligence claims only after the institution has gone into receivership. See *supra* notes 108-09 and accompanying text. Thus, the *Chapman* decision affords directors greater protection if the institution is insolvent than if solvent. See *id.* at 1127. (Posner, J., dissenting).

120. See *supra* note 31 and accompanying text.

121. For a discussion of *Canfield* and *McSweeney* see *supra* notes 47-65 and accompanying text.

122. See *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 161 (1982). Congress has authorized a federal charter system. 12 U.S.C. § 1464(a) (Supp. V 1993). In discussing Congress' authorization of federal charters, the *de la Cuesta* court noted that Congress "delegated to the [Office of Thrift Supervision] broad authority to establish and regulate 'a uniform system of [savings and loan] institutions . . .'" *de la Cuesta*, 458 U.S. at 166.

123. See 12 C.F.R. § 545.2 (1995).

financial institutions.¹²⁴

In the absence of any applicable regulations, courts have held that federally chartered institutions are subject to the laws of the state in which they operate unless those laws conflict with a federal law or impair congressional objectives.¹²⁵ Thus, whether the directors of an insolvent, federally chartered institution are subject to state law simple negligence claims depends first on whether the state law conflicts with section 1821(k).¹²⁶ Most courts agree that the second sentence of section 1821(k) constitutes a savings clause, preserving the "other applicable law"¹²⁷ of states holding directors to the higher standard of simple negligence.¹²⁸ Based on FIRREA's savings clause, a state's lesser standard of liability would not conflict with FIRREA.

However, the application of a higher standard of care under state law could arguably conflict with Congress' goal of promoting uniform banking standards.¹²⁹ Although relying on state law standards of liability could certainly create divergent standards throughout the country, FIRREA's language itself advocates different standards.¹³⁰ FIRREA utilizes a gross negligence standard, but its savings clause preserves the very state law that could create nonconformity.¹³¹ Moreover, even without FIRREA's savings clause, the statute would frustrate uniformity by expressly relying on widely varying state law definitions of gross negligence.¹³²

Congress' goal of uniformity in authorizing federal charters and the language of section 1821(k) are not necessarily inconsistent. If one reads section 1821(k) as setting a uniform minimum standard of liability and only permitting more stringent deviation by the states, then the statutory

124. See generally *id.* at §§ 541-84.

125. See, e.g., *Anderson Nat'l Bank v. Lockett*, 321 U.S. 233, 248 (1943) ("[N]ational banks are subject to state laws, unless those laws infringe the national banking laws. . . ."); *National State Bank v. Long*, 630 F.2d 981 (3d Cir. 1980).

126. Analysis under the Supremacy Clause of the United States Constitution, U.S. CONST. art. VI, cl. 2, would require preemption of state law standards of liability if those standards conflicted with federal banking law or frustrated the purpose behind federal charters. See EDWARD L. SYMONS, JR. AND JAMES J. WHITE, *BANKING LAW* 67 (3d ed. 1991).

127. 12 U.S.C. § 1821(k) (Supp. V 1993).

128. See *supra* notes 48, 55-56, 65, 87 and accompanying text.

129. See *supra* note 122 and accompanying text.

130. See *supra* notes 33-34.

131. See 12 U.S.C. § 1821(k) (Supp. V 1993). Section 1821(k) provides that "[n]othing in this paragraph shall impair or affect any right of the [federal regulatory agencies] under other applicable law." *Id.* For a discussion of cases interpreting this language to preserve state law actions for simple negligence see *supra* notes 48, 55-56, 65, 87 and accompanying text.

132. See *supra* notes 37, 56 and accompanying text.

language furthers Congress' purpose of promoting uniformity in the federal charter context.¹³³ Thus, consistent with the federal charter provisions, a uniform minimum standard may exist in harmony with FIRREA's purpose of protecting the federally insured deposit funds and empowering federal regulators.¹³⁴

Despite the potential for harmonizing the goal of uniformity with those of section 1821(k), the *Chapman* court employed the internal affairs doctrine to favor uniformity at the expense of both the statutory language of FIRREA and Congress' purposes in enacting it.¹³⁵ In effect, the court's decision signals an unwarranted judicial prioritization. The *Chapman* court myopically forced a result consistent with uniformity but ignored the fact that its decision causes FIRREA to weaken the power of federal regulators and states.

Ultimately, the *Chapman* decision affects a state's power to regulate operations within its jurisdiction by influencing the organizational decisions of a financial institution.¹³⁶ As prior cases make clear, the directors of a state chartered institution are subject to regulators' claims of state law negligence.¹³⁷ However, *Chapman* makes equally clear that the directors of federally chartered institutions are not subject to state simple negligence standards.¹³⁸ To escape state law simple negligence claims, financial institutions currently organized under state law will likely switch to federal charters for the added protection offered by the *Chapman* court.¹³⁹ By inducing institutions to choose federal rather than state charters, the *Chapman* decision takes a major step towards stripping states of their powers to regulate all forms of banking, powers that FIRREA's savings

133. Many courts have held that FIRREA's language and history indicate that Congress only intended to establish a uniform minimum standard of liability. See *supra* notes 47-65 and accompanying text.

134. Indeed, in light of Congress's decision in FIRREA to use state law to define gross negligence, absolute uniformity, be it maximum or minimum, is not possible. See *supra* notes 37, 56 and accompanying text. However, interpreting § 1821(k) to impose a uniform maximum gross negligence standard of liability on directors of federal institutions has the effect of frustrating Congress' clearly stated purpose of strengthening the power of federal regulators, see *supra* note 30 and accompanying text, and protecting the federally insured deposit fund. See *supra* note 31 and accompanying text.

135. See *supra* notes 98-100 and accompanying text.

136. For a thorough discussion of a financial institution's decision to organize with a state or federal charter see 1 MALLOY, *supra* note 24, § 10.2.

137. See *supra* notes 47-65 and accompanying text.

138. See *supra* notes 78-109 and accompanying text.

139. 12 U.S.C. § 1464(o) permits financial institutions to convert from a state to a federal charter under certain conditions. 12 U.S.C. § 1464(o) (Supp. V 1993).

clause and our federal system preserve.¹⁴⁰

C. The Internal Affairs Doctrine: Further Weakening the States

A state's role in regulating federal institutions is further diminished upon examining the *Chapman* court's internal affairs analysis. The court failed to apply the factors that traditionally rebut the presumption in favor of the charter jurisdiction's law.¹⁴¹ While the majority uses this doctrine to remove failed federal institutions from the reach of state law, Judge Posner's dissent indicates that these factors militate in favor of state law.¹⁴² If FIRREA's language and purpose do not allow application of state law standards, the *Chapman* court's application of the internal affairs doctrine as a bright line rule as opposed to a presumption makes it impossible for federal regulators to take advantage of a state standard preserved by FIRREA's savings clause and, therefore, removes a state's power to regulate failed federal institutions.¹⁴³

V. CONCLUSION

Under the gross negligence standard established in *Chapman*, FIRREA favors directors of federally chartered financial institutions doing business in states permitting actions for simple negligence. While Congress designed FIRREA to empower those seeking redress, Congress' failure to announce that FIRREA applies equally to both state and federally chartered institutions allowed the *Chapman* court to make it harder to hold those potentially responsible for the institution's failure accountable. In time, frustrated congressional intent will prompt clarification of FIRREA's

140. Using FIRREA to attract banks to adopt federal charters appears inconsistent with Congress' express decision in § 1821(k) to save state law causes of action, *see supra* notes 42-60, and therefore, the states' power to regulate. *See also* 135 CONG. REC. S4278-4279 (daily ed. April 19, 1989) (expressing federalism concerns and caution about disrupting state law with the enactment of FIRREA).

141. For a discussion of the internal affairs doctrine and how the *Chapman* court applied the doctrine, *see supra* notes 89-100, 104-07 and accompanying text.

142. *See supra* notes 104-07 and accompanying text.

143. *See Chapman*, 29 F.3d at 1125 (Posner, J., dissenting). In his dissent, Judge Posner explained the court's holding in terms that illustrate the majority's preference for federal regulation over state regulation despite the savings clause of § 1821(k). *Id.* Posner stated that:

[t]oday we hold that, despite the saving clause, state law is inapplicable . . . , because disputes involving the internal affairs of a corporation, including the duties of directors to their shareholders (in whose shoes the RTC stands), are governed by the law of the chartering jurisdiction, in this case the federal government, and the applicable law of that jurisdiction is [the gross negligence standard set out in] § 1821(k).

Id.

application to federally chartered institutions. Until such clarification, the Seventh Circuit has increased the burden on federal regulators regulating failed federal financial institutions located in simple negligence states while concomitantly decreasing a state's power to regulate the operations of federally chartered institutions operating within its borders.

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